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Knowledge About Welfare: Legal Realism and the Separation of Law and Economics

Herbert Hovenkamp[†]

I. INTRODUCTION

The modern welfare state could hardly function without making judgments about how well off or happy its citizens are. Society's public and even many of its private institutions make such judgments all the time. Governments devise progressive income taxes, which are designed to capture more wealth from those who are well off and less from the impecunious. The rationale is that taxes do less damage to the welfare of those who have more to spare. Governments also have explicit "welfare" programs, designed to provide a minimum standard of living to persons who are unable to provide such support for themselves because of disabilities or family circumstances. We have social security to guarantee our retired and elderly a certain amount of income. Both public and private colleges provide financial assistance to less wealthy students.

All of these policies presume an ability to take a manageable amount of information about an individual's income or assets and make judgments about her welfare. In fact, politicians and everyday people do this all the time, mostly without thinking about the methodological problems involved. Even adolescents become adept at knowing which of their friends are well off and which ones are not.

The superficial casualness of our daily observations about welfare belies the state of the economic science of welfare measurement. Economists have attempted to measure welfare scientifically for more than a century, but after an early period of optimism, the general history of welfare measurement has not been a happy one. Beginning mainly in the 1930s, many

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economists began to conclude that the scientific measurement of welfare involved interpersonal comparisons of utilities, and that we lacked both the observation tools and the measurement tools to make such comparisons. We lacked the observation tools because no one can ever experience the mental state of any person other than him or herself. We lacked the measurement tools because welfare, or utility, apparently does not come in cardinal units that are capable of being added, multiplied or divided. I might know that I personally like peach ice cream more than I like cauliflower, but I have no workable unit of constant measurement that enables me to tell whether I like it three times more than cauliflower or only 20% more. And I certainly cannot answer a question like: Do I like peach ice cream more than you like cauliflower?

We call our inability to compare our satisfaction with that of others the "interpersonal comparison of utilities" problem. The quantification problem we generally refer to as "ordinalism."¹ Economists responded to both of these limitations by falling back on the Pareto principle—namely that an action that affects others can be said to increase welfare if it makes at least one person better off and no one worse off. Unfortunately, few state policies ever satisfy the criterion, and no policy that requires the forcible redistribution of wealth, such as progressive income taxes, subsidized education or welfare programs, ever satisfies the Pareto criterion. All of them require one group of society's members to be taxed for the benefit of others, and thus make one social group worse off.

In the 1950s, welfare economics added to our despair when Kenneth Arrow developed his famous general impossibility theory, showing that democratic voting can never produce stable policies that can be defended as the collective choice of a democratic society. As a decision-making institution, democratic voting is generally unable to rank states of affairs according to which state contains the greatest amount of welfare.²

1. Ordinalism refers to our inability to make cardinal comparisons of utilities. This concept applies intrapersonally as well as interpersonally if one assumes that people experience declining marginal utility of income. For example, I might be willing to pay \$1,000 for good A and \$2,000 for good B, thus revealing that I place a monetary value on B that is twice as high as A. But if I also have declining marginal utility of income the first \$1,000 out of my pocketbook will be less valuable to me than the second \$1,000. In that case the amount of utility I obtain from B is more than twice A, but I do not know how much more.

2. See generally KENNETH J. ARROW, *SOCIAL CHOICE AND INDIVIDUAL VALUE* (1951). For an explanation of the problem and a very simplified and non-

As Richard Craswell has recently described this situation:

[M]ainstream welfare economics does not pretend to offer any theory of how to justify decisions that affect more than one individual, if some individuals would gain while others would lose. Unfortunately, most government decisions *do* affect more than one person (and there almost always is both a winner and a loser). By necessity, then, economists who wish to evaluate most real government decisions have had to go beyond . . . mainstream welfare economics by finding some way to compare gains and losses that are felt by different persons.³

Amartya K. Sen, one of the most prominent active welfare economists, who won the Nobel Prize in 1998, described the work of welfare economics as “devastating” for its impact on our knowledge of welfare.⁴ Sen then notes that a serious limitation of modern welfare economics is that it measures welfare exclusively by reference to the competing mental states of a society’s subjects, but he then surmises that welfare might be measured by other means, or that there might be adequate surrogates for mental states.⁵

Indeed, as philosophers since Descartes have pointed out, *any* science that requires knowledge about other people’s mental states is precarious at best.⁶ The problem with welfare economics is its esoteric assumption that one needs knowledge of other people’s mental states in order to do scientific measurement of the effects of a particular wealth distribution—an assumption which generally stops inquiry in any form of social science. Much of Sen’s own work has been dedicated to reconstructing welfare economics using “non-utility” information, or

mathematical proof, see generally Herbert Hovenkamp, *Arrow’s Theorem: Ordinalism and Republican Government*, 75 IOWA L. REV. 949 (1990).

3. Richard Craswell, *Incommensurability, Welfare Economics, and the Law*, 146 U. PA. L. REV. 1419, 1450 (1998); see also Thomas F. Cotter, *Legal Pragmatism and the Law and Economics Movement*, 84 GEO. L.J. 2071, 2090-93 (1996); Lee Anne Fennell, *Interdependence and Choice in Distributive Justice: The Welfare Conundrum*, 1994 WIS. L. REV. 235, 300-20; Cass R. Sunstein, *Incommensurability and Valuation in Law*, 92 MICH. L. REV. 779, 782-95 (1994); Richard Warner, *Impossible Comparisons and Rational Choice Theory*, 68 S. CAL. L. REV. 1705, 1733 (1995).

4. Amartya Sen, *The Possibility of Social Choice*, 89 AM. ECON. REV. 349, 351 (1999).

5. See *id.* at 359.

6. See generally Donald Davidson, *Judging interpersonal interests*, in FOUNDATIONS OF SOCIAL CHOICE THEORY 195, 203 (Jon Elster & Aanund Hylland eds., 1986) (arguing it is virtually impossible for an actor to have knowledge about other people’s mental states without making observations and comparisons with the actor’s own mental state); John C. Harsanyi, *Morality and the Theory of Rational Behaviour*, 44 SOC. RES. 623, 644-47 (1977) (discussing weaknesses in behavior theories based on preference).

information that does not depend on knowledge about someone else's state of mind.⁷

People's mental states are malleable and responsive to changes in environmental conditions—something we would expect from any responsive organism. As a result, mental states adjust to circumstances and the poor may in fact be able to develop a mental state that reflects as much happiness or utility as the wealthy have. A poor person may derive as much incremental satisfaction from finding \$5 on the street as a wealthy person derives from making \$1,000 in the stock market. Because we can neither compare mental states nor make cardinal comparisons of amount, we can never know this for sure. But it is at least as plausible as any assumption that ties mental state in some permanent and invariant fashion to material wealth.⁸ If that is so, then even if the measurement of the mental states of others were possible, it might not be a particularly good way of assessing welfare.

The American Progressives were the first legal thinkers in the United States to confront the problem of welfare measurement systematically, and to devise strategies for incorporating welfare concerns into legal policy. In legal history, the term "progressivism" refers not merely to the formal progressive movement, which largely came to an end with the election of President Harding in 1920, but to a liberal way of thinking

7. See, e.g., Amartya Sen, *Capability and Well-Being*, in *THE QUALITY OF LIFE* 30 (Martha Nussbaum & Amartya Sen eds., 1993); AMARTYA SEN, *COMMODITIES AND CAPABILITIES* (1985); AMARTYA SEN, *ON ECONOMIC INEQUALITY* (1997); Amartya Sen, *Individual Preference as the Basis of Social Choice*, in 1 *SOCIAL CHOICE RE-EXAMINED* 15-37 (Kenneth J. Arrow et al. eds., 1997); cf. Richard A. Epstein, *Law and Economics: Its Glorious Past and Cloudy Future*, 64 U. CHI. L. REV. 1167, 1174 (1997) (suggesting "that the language of 'preferences' is inadequate for economics" and that dealing with this inadequacy should be part of the agenda of law and economics).

8. See Sen, *supra* note 4, at 358. Sen writes:

A hopeless destitute with much poverty, or a downtrodden laborer living under exploitative economic arrangements, or a subjugated housewife in a society with entrenched gender inequality, or a tyrannized citizen under brutal authoritarianism, may come to terms with her deprivation. She may take whatever pleasure she can from small achievements, and adjust her desire to take not of feasibility (thereby helping the fulfillment of her adjusted desires). But her success in such adjustment would not make her deprivation go away. The metric of pleasure or desire may sometimes be quite inadequate in reflecting the extent of a person's substantive deprivation.

Id.

about policy problems that prevailed at least until the 1960s and even claims some adherents today.

A good signpost for the beginning of Progressive thinking is 1871, the publication date of Charles Darwin's *The Descent of Man*,⁹ which linked the human species to the general theory of evolution. It is also the publication date of William Stanley Jevons's *The Theory of Political Economy*,¹⁰ the first systematic attempt to apply marginalist analysis to economics.

Dating the end of Progressive legal thought is more difficult. One good candidate is 1960, the publication date of Ronald Coase's *The Problem of Social Cost*,¹¹ the single work that did more than anything to re-invigorate the law's renewed interest in the "unregulated" market. But there are alternative choices: James M. Landis's *Report on Regulatory Agencies to the President-Elect*¹² has become a symbol of our loss of faith in the Progressive vision of the regulatory state.¹³ The work of Kenneth Arrow¹⁴ and Buchanan and Tullock¹⁵ did much the same for political decision-making generally. To one degree or another each of these represents a sharp turn from the essentially republican vision of government that dominated Progressive legal thought, to a more classical liberal view emphasizing the uniqueness and centrality of individual preference, the effi-

9. CHARLES DARWIN, *THE DESCENT OF MAN, AND SELECTION IN RELATION TO SEX* (London, J. Murray 1871).

10. W. STANLEY JEVONS, *THE THEORY OF POLITICAL ECONOMY* (4th ed. 1911).

11. Ronald Coase, *The Problem of Social Cost*, 3 J.L. & ECON. 1 (1960).

12. JAMES M. LANDIS, *REPORT ON REGULATORY AGENCIES TO THE PRESIDENT-ELECT* (1960).

13. One must acknowledge some precursors to Landis's pessimism about government agencies. See MARVER BERNSTEIN, *REGULATING BUSINESS BY INDEPENDENT COMMISSION* (1955); Samuel P. Huntington, *The Marasmus of the ICC: The Commission, the Railroads, and the Public Interest*, 61 YALE L.J. 467 (1952); Louis L. Jaffe, *The Effective Limits of the Administrative Process*, 67 HARV. L. REV. 1105 (1954) [hereinafter Jaffe, *Limits*]; Louis L. Jaffe, *Investive and Investigation in Administrative Law*, 52 HARV. L. REV. 1201 (1939); Louis L. Jaffe, *The Report of the Attorney General's Committee on Administrative Procedure*, 8 U. CHI. L. REV. 401 (1941); see also HENRY J. FRIENDLY, *THE FEDERAL ADMINISTRATIVE AGENCIES: THE NEED FOR BETTER DEFINITION OF STANDARDS* (1962); THOMAS K. MCCRAW, *PROPHETS OF REGULATION* 210, 215, 219-20, 234-35 (1984); Richard B. Stewart, *The Reformation of American Administrative Law*, 88 HARV. L. REV. 1669, 1677-78 (1975). Landis had been the author in 1938 of the much more optimistic *THE ADMINISTRATIVE PROCESS* (1938).

14. See ARROW, *supra* note 2.

15. See JAMES M. BUCHANAN & GORDON TULLOCK, *THE CALCULUS OF CONSENT* (1962).

ciency and robustness of private markets, and the many imperfections of public processes.

Progressive legal thought developed out of the coalescence of three important ideas: (1) Darwinism in the social sciences, which was the view that all organisms, including the human race, are both evolving and struggling to survive in an essentially hostile environment; (2) marginalism in economics, which stressed that rational people make choices by ranking their preferences, committing resources to that which they want most first, and so on; and (3) objective welfare judgments, which are basically judgments about welfare that do not depend on assumptions about other people's mental states. Largely as a result of (3), Progressive legal thought was more republican than liberal in its social theory. Largely as a result of (1) and (3), Progressive legal thought was never very comfortable with mainstream neoclassical economics. Indeed, one characteristic of Progressive legal thought is that elite legal thinking became more divorced from mainstream American economics than at any time in our history. Progressive legal thought from roughly 1925 to 1960 is characterized by an unprecedented separation of law and economics.¹⁶ The result was that while economists became increasingly strict and pessimistic about the science of measuring welfare, Progressive legal policy was able to lay the foundation for the New Deal, and later the Great Society—both based on visions about the role of government that required elaborate and ubiquitous assumptions about people's welfare.

To paint with a broad brush, this separation of law and economics resulted in part from changes in economic theory that occurred in the 1930s. Up to that time marginalist economic theory appeared to justify widespread, state-enforced wealth distribution and intervention in the market. Then developments in economic methodology and economists' own perception of the relation between economic science and policy making cast doubt on this welfare agenda.¹⁷

Progressive legal thought responded to the new economic theory, not by rejecting its wealth distribution agenda in favor of more market-oriented policies, but rather, by abandoning the close historical link that always had existed between legal pol-

16. See discussion *infra* Part IV.

17. See discussion *infra* Part IV.

icy and prevailing economic theory.¹⁸ After 1930, legal policy was dominated by legislative concerns about welfare and wealth distribution, even though economists increasingly regarded such concerns as outside the scope of their discipline. Even policies regarding economic regulation, regulation of competition, and administration of the common law were largely divorced from mainstream economic theory.

To be sure, many legal thinkers continued to do economics, but by and large the economics that dominated both legislative agendas and legal scholarship was cast off or obsolete theories that mainstream economists no longer embraced. Just as mainstream economists were developing the neoclassical theory of competition, legal policy seemed to assume that markets often were subject to failure, and that regulatory agencies could make superior decisions about the allocation of resources. Concerns defined as "economic" often identified equality rather than efficiency as the appropriate goal. The federal income tax became increasingly progressive and transferred larger portions of people's income into the public sector.¹⁹ Even the common law incorporated distributive policies that assumed it was the judge's mandate to level the playing field between the powerful and the impotent.²⁰

18. On this close link prior to the 1930s, see Herbert Hovenkamp, *The First Great Law and Economics Movement*, 42 STAN. L. REV. 993, 993-1031 (1990).

19. The highest marginal tax rate rose significantly during World War I, fell back and began rising during the New Deal until it reached a peak of 94% on incomes exceeding \$200,000 during World War II. During the post-war forties the highest marginal rate was around 85%, and during all of the 1950s, it was in the low nineties (91% under the influential 1954 Code). In 1965, it fell to 70% and has been falling since. Further, at no time from 1900 until the beginning of World War II were more than 10% of the population made subject to the tax because the minimum taxable income was so high. During World War II, that number rose dramatically to 57.1% and has generally increased since then. Of course, the complete story is far more complicated. First, the total redistribution effected by the tax depends not only on the highest rate, but also on where the income gradations appeared, and the percentage of taxpayers that had to pay each rate. Further, other provisions in the code may have made actual rates higher or lower than apparent rates. For a summary of the historical data, see RICHARD GOODE, *THE INDIVIDUAL INCOME TAX* 308 (rev. ed. 1976).

20. See, e.g., *Williams v. Walker-Thomas Furniture Co.*, 350 F.2d 445, 448-50 (D.C. Cir. 1965); GRANT GILMORE, *THE DEATH OF CONTRACT* (1974).

II. THE INTELLECTUAL SOURCES OF PROGRESSIVE LEGAL THOUGHT

Progressive legal thought originated in the consolidation of two powerful scientific ideas from the second half of the nineteenth century, Darwinism and marginalism. For approximately two generations Darwinism and marginalism appeared to unite the biological and human sciences with economics, and to provide a complete picture of human welfare and social obligation.

This convergence of ideas gave Progressives a complete theory of human nature, addressing fundamental questions about individual welfare and incentive on the one hand, and social relations and obligations on the other. Marginalism provided a much more rigorous theory of welfare and incentive than anything that classical political economy had offered.²¹ Darwinism offered not only a principle of physical development, but also a theory of community and culture, and suggestions about the welfare role of the State.

The Progressive intellectual could believe that, through marginalism, he had discovered a theory of human welfare based on free choice. The concept of preference orderings, or declining marginal utility, readily lent itself to mathematical quantification.²² But as a result of his Darwinism, the Progressive intellectual could also believe that the same set of welfare needs applied more or less equally to every member of society. Darwinian evolution was the great equalizer: in any given environment those organisms that succeeded in the struggle against nature tended to have the same characteristics. As a result, Progressive policymakers tended to believe that by altering the environment or giving its human members the same set of survival tools, they could increase the chances of success. Darwinism thus permitted liberal policymakers to generalize about individual welfare needs without ever making the assumption that economists made that welfare is a function of mental states. Darwinists measured welfare in terms of survival characteristics, which largely were external to state of mind, while economists measured welfare by observing choices.

21. See generally Herbert Hovenkamp, *The Marginalist Revolution in Legal Thought*, 46 VAND. L. REV. 305 (1993).

22. See, e.g., F.Y. Edgeworth, *The Pure Theory of Taxation III*, 7 ECON. J. 550 (1897); F.Y. Edgeworth, *The Theory of Distribution*, 18 Q.J. ECON. 159 (1904). On Edgeworth and his influence on incipient law and economics in the United States, see Hovenkamp, *supra* note 18, at 1002-03.

Thus, both Darwinism in biology and marginalism in economics helped forge the progressive legal mentality. Darwinism has received most of the attention from historians,²³ however, while marginalism has until recently been overlooked or relegated to a secondary position. This is an unjustified imbalance that seriously understates the economic content of the Progressive legal revolution.²⁴ By underemphasizing the role of marginalism in Progressive legal thought, historians also understate the role of economics in the earlier period of legal thought, which we generally call "classical."²⁵ The principal concerns of law have always been economic, and much of the Progressive legal revolution was concerned with improving economic welfare, and in defining the relative roles of private markets and state command in the allocation of resources.

A. DARWINIAN EVOLUTION

Evolution by natural selection was Charles Darwin's theory of the development of species. The theory was that nature produces many more offspring than any particular environmental niche can accommodate; further, one species continually preys on others. Individuals that by chance inherit characteristics best suited for survival in their particular environment tend to pass these characteristics on to their own offspring. The others die and their less resilient characteristics vanish.

Darwinism had a powerful intellectual influence on emergent social science,²⁶ and particularly on American legal

23. See, e.g., HENRY STEEL COMMAGER, *THE AMERICAN MIND* 41 (1950); RICHARD HOFSTADTER, *SOCIAL DARWINISM IN AMERICAN THOUGHT* 30 (rev. ed. 1955); ARNOLD M. PAUL, *CONSERVATIVE CRISIS AND THE RULE OF LAW* (1960); EDWARD A. PURCELL, JR., *THE CRISIS OF DEMOCRATIC THEORY* (1973); MORTON WHITE, *SOCIAL THOUGHT IN AMERICA: THE REVOLT AGAINST FORMALISM* 104-05 (Viking Press 1949) (1957).

24. One corrective is DOROTHY ROSS, *THE ORIGINS OF AMERICAN SOCIAL SCIENCE* (1991). See also Hovenkamp, *supra* note 18; Hovenkamp, *supra* note 21.

25. See MORTON J. HORWITZ, *THE TRANSFORMATION OF AMERICAN LAW, 1870-1960: THE CRISIS OF LEGAL ORTHODOXY* 9-31 (1992). See generally HERBERT HOVENKAMP, *ENTERPRISE AND AMERICAN LAW, 1836-1937* (1990); WILLIAM M. WIECEK, *THE LOST WORLD OF CLASSICAL LEGAL THOUGHT* (1998). On the relationship between economics and morals in classical legal thought, see generally Herbert Hovenkamp, *Law and Morals in Classical Legal Thought*, 82 IOWA L. REV. 1427 (1997).

26. See generally MARY FURNER, *ADVOCACY AND OBJECTIVITY: A CRISIS IN THE PROFESSIONALIZATION OF AMERICAN SOCIAL SCIENCE, 1865-1905* (1975); ROSS, *supra* note 24; Herbert Hovenkamp, *Evolutionary Models in Jurisprudence*, 64 TEXAS L. REV. 645 (1985).

thought. The group of turn-of-the-century Darwinists who became the most prominent were the "Social Darwinists." They believed that evolution was progressive, in the sense that the surviving species were physically, mentally, and even morally superior to those that did not survive. Social Darwinists also believed that evolutionary progress could run its course only if the state restrained itself from interfering. State policy designed to provide support for the poor or other inferior members of society might be well intended, but its most enduring consequence was to preserve the lives of those that nature would have sacrificed.²⁷ As a result, the evolutionary progress of humanity was thwarted. Social Darwinists objected to such legal institutions as progressive income taxation, workers' protective legislation such as state wage-and-hour laws, or poor relief. All of these undermined the natural evolutionary process.

In the 1950s, historians exaggerated the role of Social Darwinism and often used the term to describe political and social views that antedate Darwin and were well established in the early nineteenth century.²⁸ The real Darwinian revolution in the sciences lay not in the rather overblown rhetoric of the Social Darwinists, but in methodological reformulations that guided the development of modern social science. Most of this occurred after 1880.²⁹

At the other end of the political spectrum from the Social Darwinists were the Reform Darwinists, whose distinguishing belief was that human beings are unique in the evolutionary process. While all organisms are evolving, only humans are aware of this fact and in a position to control, or "manage," the evolutionary process. While Social Darwinists believed in a minimalist state, Reform Darwinists were statist. They believed that the state should be actively involved in guiding the evolutionary process to produce the best individuals possible, and to improve the lives of those who were not the best.³⁰

27. For the strongest statement of the thesis that Social Darwinism dominated Gilded Age American thought, see HOFSTADTER, *supra* note 23.

28. See generally ROBERT C. BANNISTER, *SOCIAL DARWINISM: SCIENCE AND MYTH IN ANGLO-AMERICAN SOCIAL THOUGHT* (1979); HOVENKAMP, *supra* note 25, at 99-101.

29. See ROSS, *supra* note 24, at 257-302, 390-470.

30. See generally EDWARD ALSWORTH ROSS, *SOCIAL CONTROL* (1901); LESTER FRANK WARD, *DYNAMIC SOCIOLOGY* (Johnson Reprint Corp. 1968) (1883); LESTER F. WARD, *GLIMPSES OF THE COSMOS* (1913). On Reform Darwinism, see Hovenkamp, *supra* note 26, at 671-83; see also L.I. BERNARD & JESSIE BERNARD,

Social Darwinism is often described as a kind of extreme individualism that believes that all human urges are both self-ish and unique. As a result, some intellectual historians have treated Social Darwinism and classical political economy as if they amounted to the same thing:³¹ both place a strong value on individual preference and abhor state interference in markets.

But classical political economy and Social Darwinism began from very different starting points. For the classicists, human preference was both autonomous and highly individual. By contrast, *homogeneity* fostered the competition described in the Social Darwinist model. The struggle for existence among individuals within the Darwinian paradigm was so intense because on most fundamental points the individuals who were competing were alike, not because they were different. Had they been sufficiently different they could have sought out alternative niches and survived without competing. For Darwinists of every kind, human preference was hardly autonomous. Rather, preference was nothing more than the instinct for survival,³² and the evolutionary process guaranteed that surviving organisms would have similar sets of preferences. This fact permitted Darwinians to make categorical, or "objective" judgments about human welfare that economics would eventually reject as based on unscientific interpersonal comparisons of utility.³³

B. MARGINALISM

Although Darwinian intellectual ideas were very powerful at the turn of the century, they were no more powerful than marginalism, which revolutionized economics during the same

ORIGINS OF AMERICAN SOCIOLOGY: THE SOCIAL SCIENCE MOVEMENT IN THE UNITED STATES (1943); JOHN C. BURNHAM, LESTER FRANK WARD IN AMERICAN THOUGHT (1956); ROBERT FARIS, CHICAGO SOCIOLOGY, 1920-32 (1967); HOFSTADTER, *supra* note 23, at 64-84; JULIUS WEINBERG, EDWARD ALSWORTH ROSS AND THE SOCIOLOGY OF PROGRESSIVISM (1972).

31. See generally COMMAGER, *supra* note 23.

32. The evolutionary psychologists made this clear. See generally WILLIAM CHANDLER BAGLEY & STEPHEN S. COLVIN, HUMAN BEHAVIOR (1913); JOHN DEWEY, HOW WE THINK (1910); WILLIAM MCDUGALL, AN INTRODUCTION TO SOCIAL PSYCHOLOGY (8th ed. 1914); MAX FRIEDRICH MEYER, THE FUNDAMENTAL LAWS OF HUMAN BEHAVIOR (1911); IVAN PETROVICH PAVLOV, CONDITIONED REFLEXES (1927); JOHN B. WATSON, BEHAVIORISM 6 (1924); JOHN BROADUS WATSON, PSYCHOLOGY FROM THE STANDPOINT OF A BEHAVIORIST (2d ed. 1924); ALBERT PAUL WEISS, A THEORETICAL BASIS OF HUMAN BEHAVIOR (1925).

33. See discussion *infra* text accompanying notes 64-84.

years. Marginalism originated in the writings of the English utilitarians. By the 1790s Jeremy Bentham already had examined utilitarianism's economic implications and developed an embryonic theory of marginal utility. Declining marginal utility of income and the value of marginal deterrence in criminal law were both developed in Bentham's *Principles or Morals* and his *Theory of Legislation*.³⁴ Under declining marginal utility of income, although a person experiences increasing personal value from additional wealth, the rate of increase—that is, a person's millionth dollar gives considerably less satisfaction than her first dollar did. Under the theory of marginal deterrence, the state can limit greater crimes by varying penalties. For example, if theft and murder are both punishable by death, the robber has little incentive not to kill his victim. But if theft is punishable by five years in prison and murder by death, the robber may decide that the former crime is worth the risk but not the latter.

Marginalism became a coherent movement within economic theory in the 1870s. Working separately, Englishman William Stanley Jevons and Austrian Carl Menger sought to combine marginal utility theory with classical economics. Jevons's *Theory of Political Economy*³⁵ broke sharply with classical political economy by disputing the nearly sacred notion that value depends on the amount of labor that has previously

34. JEREMY BENTHAM, AN INTRODUCTION TO THE PRINCIPLES OF MORALS AND LEGISLATION (J.H. Burns & H.L.A. Hart eds., 1970) (1789); JEREMY BENTHAM, THE THEORY OF LEGISLATION (Etienne Dumont Hildreth trans., 1864). Bentham did not come close to developing the theory of marginal cost or theories of value based on marginalism.

35. WILLIAM S. JEVONS, THE THEORY OF POLITICAL ECONOMY (H. Stanley Jevons ed., 4th ed. 1911) (1871). Alfred Marshall also deserves part of the credit. See generally 1 THE EARLY ECONOMIC WRITINGS OF ALFRED MARSHALL (J.K. Whitaker ed., 1975). For perspective on the rise of marginalism, see D.E. MOGGRIDGE, MAYNARD KEYNES: AN ECONOMIST'S BIOGRAPHY 84-86 (1992). In the United States, John Bates Clark probably came to his marginalism independently. See generally JOHN BATES CLARK, THE PHILOSOPHY OF WEALTH 56-90 (Augustus M. Kelley Publishers 1967) (1886); JOSEPH A. SCHUMPETER, HISTORY OF ECONOMIC ANALYSIS 870 (1954).

Carl Menger's PRINCIPLES OF ECONOMICS (James Dingwall & Bert Hoselitz trans., 1981) (1871) was less influential in the United States than Jevons's work, since Menger stood outside the British classical tradition. However, a large group of American graduate students in political economy who went abroad for graduate study in the late nineteenth century ended up on the continent, especially in Germany, and many of them studied Menger. On the influence of German historicism on Progressive Era economics, see FURNER, *supra* note 26, at 50-57; ROSS, *supra* note 30, at 104-05; Hovenkamp, *supra* note 18, at 996-97.

gone into something. Rather, "value depends entirely on utility," which is a purely subjective notion related to the preference of the buyer.³⁶ This measure of value might be unrelated to the amount of previous investment.³⁷ For economics, the most important contribution of marginal utility theory was its principle of exchange—that is, the way it explained how markets work. "[W]e have only to trace out carefully the natural laws of the variation of utility, as depending upon the quantity of commodity in our possession, in order to arrive at a satisfactory theory of exchange."³⁸ A person's willingness to pay depends on the absolute strength of his preferences for the desired good, the amount he already has, and the strength of preference for what he gives up in exchange. From the economic theory of diminishing marginal utility, Jevons also developed the concept of equal utilities—that a person applying her money to numerous commodities will purchase an amount of each up to the point that she derives the same marginal utility from all.³⁹

For the marginalists, value was entirely subjective, based on individual preference rather than any property of the desired good itself. As a result, marginalism forced a shift in economics' methodology away from the measure of *things* to the measure of human behavior. "Value" no longer referred to the amount of something that was available or the historical cost of production; rather, it described a kind of behavior and was measured by marginal willingness to pay. For example, the great marginalist economist Alfred Marshall knew that the whole notion of subjective preference meant nothing at all unless preference could be measured behaviorally. Thus, one could speak meaningfully of consumer demand only "as represented by the schedule of the prices at which he is willing to buy different amounts of it."⁴⁰ In the highly influential eighth edition of his *Principles of Economics*, Marshall wrote:

If then we wish to compare . . . physical gratifications, we must do it not directly, but indirectly by the incentives which they afford to action. If the desire to secure either of two pleasures will induce people

36. JEVONS, *supra* note 35, at 1 (emphasis omitted).

37. *See id.* at 1-2.

38. *Id.*

39. "[W]hen the person remains satisfied with the distribution he has made, it follows that . . . an increment of commodity would yield exactly as much utility in one use as in another." *Id.* at 59.

40. ALFRED MARSHALL, *PRINCIPLES OF ECONOMICS* 158 (London, MacMillan 1890).

in similar circumstances each to do just an hour's extra work, or will induce men in the same rank of life and with the same means each to pay a shilling for it; we then may say that those pleasures are equal for our purposes, because the desires for them are equally strong incentives to action for persons under similar conditions.⁴¹

This shift in emphasis affected not only economics, but all of the social sciences generally.

1. Marginalist Explanation

Marginalism seemed to explain many of the puzzles that had frustrated classical political economy. For example, the classicists had been hard pressed to explain why people and firms produce and consume different mixtures of goods, and why goods appear to have widely different values. Why is water cheap, even though it is essential for survival? Why are diamonds expensive, even though they are non-essential luxuries? More generally, classical political economists had great difficulty with the concept of cost, and determining the relationship between the cost of something and its value.⁴²

Marginalism provided a method for answering all these questions. *First*, when people place value on goods, only the marginal value, not the total value and not even the historical cost, is relevant. *Second*, people tend to equate utilities over their entire set of purchasing decisions. Presumptively, every person's stock of goods is such that her marginal values are all precisely identical. To the extent they are not, she corrects the situation by buying whatever has the highest marginal value.⁴³ *Third*, business firms, whose goal is the maximization of profits, also equate marginal utilities, but these are measured as marginal expenditures and marginal revenues.⁴⁴

Within economics, marginalism provided a basis for a general theory of consumer demand, of human incentives, a theory of value, a theory about production and consumption, and a theory of costs. All of these could be quantified with great apparent mathematical precision. Thanks to marginalism, neo-

41. ALFRED MARSHALL, PRINCIPLES OF ECONOMICS 15-16 (8th ed. 1920).

42. See Hovenkamp, *supra* note 21, at 311.

43. For illustrations, see *id.* at 311-12.

44. For example, in deciding what inputs to use in making a product, the firm maximizes its profits by using each input up to a point that its marginal cost is identical to the marginal cost of every other input. If labor and machinery are alternative inputs into a product and the current cost of labor is \$5 per unit of value produced while the current cost of machinery is \$4, the firm will invest in more machinery and less labor until the two are equalized. See *id.* at 313.

classical economics became more coherent and rigorous than classicism had ever hoped to be.

Just as Darwinism almost immediately stretched beyond the biological sciences, so too marginalism reached beyond economics. Marginalism promised a theory of individual behavior and human rationality. It purported to explain both how human incentives could be controlled, and how human welfare could be improved. For these reasons marginalism provided an important intellectual foundation for the Progressive revolution in legal thought.

2. Marginalism and Markets

By and large, Progressives believed in markets, although they found markets to be much more fragile than the classicists had. Marginalist theory initially presented a host of technical problems for the classical model of competition. The marginalist model of perfect competition required constant costs of production, fungible products, and no fixed costs. Just at the time the marginalist model of competition was being developed, however, industry was going through a revolution characterized by significant economies of large scale production, product differentiation, and high fixed costs.⁴⁵ The natural result was a consensus that the conditions for healthy competition existed only as the exception rather than the rule. During the period from roughly 1890 through the New Deal, economists' faith in market competition to allocate resources appropriately was extraordinarily low.⁴⁶ The 1940s then witnessed a renaissance in neoclassicism, although much more technical and mathematical than the neoclassicism of the turn of the century.⁴⁷ Further, the new neoclassicism incorporated New Deal anomalies such as product differentiation, monopolistic competition, and imperfect competition into the model rather than treating them as significant departures from the model. As a policy science, this revitalized neoclassicism was concerned to ensure that markets were workably competitive even though the conditions for perfect competition were not precisely satisfied.⁴⁸

45. See HOVENKAMP, *supra* note 25, at 296-364.

46. See, e.g., ARTHUR ROBERT BURNS, *THE DECLINE OF COMPETITION* (1936); EDWARD CHAMBERLIN, *THE THEORY OF MONOPOLISTIC COMPETITION* (1933); J. MAURICE CLARK, *STUDIES IN THE ECONOMICS OF OVERHEAD COSTS* (1923).

47. See generally, e.g., PAUL ANTHONY SAMUELSON, *FOUNDATIONS OF ECONOMIC ANALYSIS* (1947).

48. See generally, e.g., J.M. Clark, *Toward a Concept of Workable Competi-*

III. PROGRESSIVE LEGAL THOUGHT AND LEGAL REALISM

Progressive legal thought was formed from these premises:

(1) human beings are evolving biological creatures just as other organisms, and their preferences are shaped entirely by the instinct for survival;

(2) human beings differ from other organisms in that they are capable of "managing," or steering, the evolutionary process to suit their purposes;

(3) individuals have needs and desires for goods, but for any good the intensity diminishes as one has more;

(4) both individuals and business firms "maximize" by equating the marginal utilities of everything they buy and sell;

(5) markets are far less robust than the classical political economists had supposed;

(6) the homogeneity among individuals dictated by the evolutionary process makes it possible to make interpersonal comparisons of welfare needs;

(7) the state can improve welfare by involving itself in the process of resource allocation and transfer.

The result of these ideas was a complete and coherent theory of human choice, of business firm behavior, and of public policy. While Progressive theory took individual preference into account, it also believed that the evolutionary process produced substantial homogeneity of preference. Further, because preference is nothing more than the instinct for survival, its content can be inferred from study of the evolutionary process itself. Progressive legal thought was thus individualistic and liberal in its theory of choice, but collectivist in its theory of human nature and well-being.

Under neoclassical economic analysis, one cannot rest judgments about welfare on interpersonal comparisons of cardinal (i.e., weighted) utilities. But the Darwinian scheme did not rest its judgments about welfare on "utility" information at all. For the Darwinian Progressives a preference is nothing more than an instinct, and instincts are driven by survival needs that can be objectively measured. As a result, a decisive characteristic of Progressive legal thought was its tendency to make *objective* rather than preference-based judgments about

tion, 30 AM. ECON. REV. 241 (1940). For an attempt to give policy effect to these ideas, see ATTORNEY GENERAL'S NAT'L COMM. TO STUDY THE ANTITRUST LAWS, REPORT (1955).

welfare. This ultimately entailed a decisive separation between the "welfare" judgments of Progressive legal thought and the "welfare" judgments made by neoclassical economics.⁴⁹

For Progressive legal thinkers, Darwinism and marginalism made separate but complementary contributions to policy. Darwinism provided the biological foundations for viewing human beings as having similar welfare needs so as to compete for survival in the same environmental niche. Marginalism provided a mechanism for evaluating individual preferences that could be quite diverse. Likewise, while Darwinism supplied Progressive legal thought with its intellectual background and much of its rhetoric, marginalism provided more technical and concrete premises for making policy.

The coalition of Darwinism and marginalism also justified the Progressive commitment to a "mixed" economy, or one in which resources are allocated by a combination of private markets and state command. Insofar as survival was concerned, the state had a prominent role to play; but insofar as there was a surplus, its disposition was best left to individual choice. As a result, while Progressive legal thinkers were often quite paternalistic about perceived survival needs, their ideas about the State nevertheless left substantial room for individual autonomy. The state intervened to the point of providing a standard of living capable of sustaining survival and productivity; the essentially unregulated market then managed the surplus.

Progressives believed that government regulation was justified on two quite different grounds. *First*, it could correct market failures and restore economic efficiency. Because Progressives tended to believe that markets were fragile, they tended to find more market failures requiring regulatory intervention. *Second*, their view of the state's redistributive role entailed that regulation should be used to level the playing field or aid the economically disadvantaged even at the expense of losses in efficiency as measured by neoclassical criteria.

The result often was a regulatory regime that served simultaneously to serve efficiency and distributive goals, that was not always careful to distinguish the two, and that was frequently naive about the political vulnerability of the regulatory process. It was no wonder that post-Progressive critics found the Progressive regulatory institutions such fragile targets.

49. See *infra* text accompanying notes 62-84.

A. THE IMPACT OF MARGINALISM ON PROGRESSIVE LEGAL THOUGHT

Marginalism refocused Progressive legal thought in four ways. First, as Darwinians, Progressives believed that human beings shared most of their welfare needs in common. For that reason, one could legitimately speak of a transfer of wealth from the rich to the poor as increasing welfare. For the wealthy, the final dollar would be stuffed into a bank account or used only for luxuries, while the impoverished would use it to purchase food or shelter. Markets do not systematically transfer wealth: exchanges are made only if both participants believe they will be wealthier (with wealth measured by preference) after the exchange has occurred. Progressives developed a relatively broad based theory of wealth distribution that required sovereign intervention in the market. Consistent with this theory the Progressives favored not only more progressive tax structures,⁵⁰ but also workers' compensation laws that would automatically give pensions to those disabled by on-the-job injuries; minimum wage and maximum hour legislation; and legislation encouraging the formation and activities of labor unions. During the heyday of Progressive law and economics, roughly from 1890 to 1920, this view was also consistent with the prevailing economics. In the 1930s, mainstream economics abandoned its belief in interpersonal utility comparisons, however, and the legal and economic conceptions of "welfare" began to diverge sharply.

Second, marginalism in economics, coupled with Darwinism in the social sciences, contributed to a broad redefinition of American policies respecting crime, mental handicap and race, emphasizing marginal deterrence and productivity. Holmes's new presentation of the common law as concerned with the metering of sanctions did substantially the same thing for common law rules and remedies.⁵¹ For example, the purpose of the law of contract damages was nothing more than to give people an incentive to perform contracts, and to enable them to meter the penalty costs of breaching against the gains.⁵²

50. See, e.g., Hovenkamp, *supra* note 18, at 1002-05; Edwin R.A. Seligman, *Progressive Taxation in Theory and Practice*, PUBLICATION AM. ECON. ASS'N, Jan.-Mar. 1894, at 1, 132-33.

51. See Hovenkamp, *supra* note 21, at 335-45; see also *infra* notes 56-61 and accompanying text.

52. See Oliver W. Holmes, *The Path of the Law*, 10 HARV. L. REV. 457, 462 (1897).

Third, marginalism ended the commitment of American economists to the wage-fund doctrine, which held that there was an "iron law" regarding wage rates, and that to force employers to pay more was to invite disaster for the very workers that the legislated increase was designed to protect.⁵³ Rather, wages were thought to be based on the marginal contribution that a worker made to the production process. An employer would not hire a worker who did not make this contribution. As a result, reasonable minimum wage laws would have little harmful effect except perhaps to reduce employment slightly by making labor less attractive at the margin of production.⁵⁴

Fourth, economic marginalism enabled a wholesale revision of corporate law, particularly corporate finance, in which valuation of corporations and their stock was predicated on anticipated profitability rather than historical investment. This revolution was so complete that corporate finance theory of the 1920s barely resembled the theory of the 1880s. For example, classical corporate finance theory estimated the value of corporate shares by asking how much capital historically had been paid into the firm. By contrast, the neoclassical theory of corporate finance understood that the value of shares depended on anticipated profitability rather than historical capitalization.⁵⁵

B. "NEOCLASSICAL" LEGAL THOUGHT

Not all of legal classicism's critics can be classified as Progressives. The best counter-example is Holmes, who was just as Darwinian and marginalist as the Progressives.⁵⁶ The marginalist and Darwinian revolutions produced conservatives who were nearly as anti-statist and pro-market as the classicists that preceded them.

53. On the wage-fund doctrine in the United States, see HOVENKAMP, *supra* note 25, at 193-98.

54. That is, assuming that the marginal productivity of labor declines, the employer paying \$1.00 per hour would continue to hire workers as long as the last worker hired contributed \$1.00 or more; but if constrained to pay \$1.10 per hour, the employer would stop hiring additional workers at the point that the marginal contribution was \$1.10. The employer might simply produce less, or might make a somewhat larger investment in machinery or other alternatives to labor.

55. See Hovenkamp, *supra* note 21, at 346-58.

56. See E. Donald Elliott, *Holmes and Evolution: Legal Process as Artificial Intelligence*, 13 J. LEGAL STUD. 113, 140 (1984); Hovenkamp, *supra* note 26, at 656-64; Hovenkamp, *supra* note 21, at 335-45.

Marginalism was not only a theory of human welfare and value; it was also a theory of incentives. Neoclassicists emphasized the latter. They were deeply skeptical about the Progressive commitment to use the state to readjust human fortunes. Neoclassical marginalism emphasized deterrence rather than distribution, and focused on the State's role in altering incentives by rewarding or penalizing conduct. Holmes took a distinctly marginalist position when he argued that a penalty for breaching a contract is nothing more than the price of the breach. The same principal explained tort law: we continually compare the cost of taking precautions with the costs of anticipated losses that more careful behavior might have prevented. In his 1881 lectures on *The Common Law*, Holmes completely rewrote the law's system of individual incentives along marginalist lines, but throughout his life he remained extraordinarily skeptical about state programs designed to improve the lives of the poor and laboring classes.

The second important distinction between Progressive and neoclassical legal thinkers was the differing amounts of faith or distrust that each group placed in the market, and the corresponding distrust or faith that each placed in government regulation. Progressives doubted the efficacy of markets as no group of American legal thinkers ever had. During their lifetimes they witnessed technological innovations and a mania for business combinations that appeared to them to transform American industry from one of hundreds of competitive producers to tight oligopolies of a few giant firms.⁵⁷ They also witnessed the dramatic rise of the family fortunes of the masters of this new wealth, such as the Goulds and the Rockefellers, just as they saw the equally dramatic rise of large scale urban poverty. All of this threatened to undermine the Jeffersonian and later Jacksonian vision of a society where anyone who wished could become an entrepreneur.

For the Progressives, the market was at fault on both counts. First, it produced noncompetitive structures. Second, it transferred wealth, although in the wrong direction—to those who already had a great deal, and away from those who were already impoverished.⁵⁸ One of the most lasting and controversial contributions of Progressive legal thinkers was their dis-

57. See HOVENKAMP, *supra* note 25, at 241-307.

58. This was the central thesis of Progressive economist Richard T. Ely's *PROPERTY AND CONTRACT IN THEIR RELATIONS TO THE DISTRIBUTION OF WEALTH* (1914).

trust of the market, and their faith that the government agency, whose salaried officials did not profit from their decisions, could regulate the economy better than private self-interested market participants. In two stages, first during the Progressive Era and later during the New Deal, Progressive policymakers erected the modern administrative state, which substituted government control for market bargaining in many areas of the economy.

Beginning around 1960, much of this faith was shattered when policymakers began to appreciate that regulatory agencies were often captured by the very firms that they were supposed to regulate, and that they were costly to operate and often prone to error, even under the best of circumstances.⁵⁹ Political scientists and others working in related disciplines began to emphasize the power of special interests, other serious imperfections in the political process, and the inability of majority voting to produce stable results that could be said to maximize the social welfare.⁶⁰ Coase's work⁶¹ was widely interpreted as indicating the superiority of private markets over state command as a resource allocation device. For Progressive legal thought, that was the beginning of the end.

IV. THE SEPARATION OF LAW AND ECONOMICS

By contrast to Progressive legal thinkers, neoclassical economists wished to rehabilitate classicism's free market rather than jettison it. They never gave up the classical belief that the essentially unregulated market should be the dominant mechanism for ordering property rights and exchange in the United States. The neoclassical revolution in economics, which initially found many reasons to distrust the market, gradually reconstructed a theoretical model in which most markets appeared to function quite well. From that point marginalism's theory of incentives seemed only to strengthen the case for letting the market, rather than state policy, determine individual wealth.⁶² The "ordinalist" revolution of the 1930s

59. See MCCRAW, *supra* note 13, at 153-221. See generally LANDIS, *supra* note 12; Jaffe, *Limits*, *supra* note 13.

60. See generally ARROW, *supra* note 2; BUCHANAN & TULLOCK, *supra* note 15. On public choice and social choice theory, see generally DANIEL A. FARBER & PHILIP P. FRICKEY, *LAW AND PUBLIC CHOICE: A CRITICAL INTRODUCTION* (1991); DENNIS C. MUELLER, *PUBLIC CHOICE II* (1989).

61. See generally, e.g., Coase, *supra* note 11.

62. See George Stigler, *Perfect Competition, Historically Contemplated*, 65 J.

completely undermined the Progressive theory of social welfare, while leaving the theory of individual incentives largely intact.⁶³ The former required interpersonal utility comparisons while the latter did not. After the 1930s marginalism was thought to apply to the range of decisions facing the individual economic actor, but to say nothing about the welfare consequences of state-imposed redistribution. Neoclassical economics then moved back to the political right, to a much stronger commitment to the free market.

Progressive legal thought responded, not by returning to American law's previous commitment to markets and state non-intervention, but rather, by abandoning mainstream neo-classical economics as an important source of its perspective on welfare and markets. This Part traces these developments.

A. THE "SOCIAL VALUE" DISPUTE

Marginalist economics at the turn of the twentieth century maintained a "social" conception of economic value. Certain commodities or opportunities were thought to have a value to the group that was different than the sums of the values that individuals asserted in the marketplace. Those who believed in "social" value believed that the concept of value was meaningless unless it was used to describe groups rather than individuals. The main reason this was true was that in markets of competing buyers and sellers the price of a good depended not merely on individual willingness to pay in the abstract, but on the amount of competition in production and the amount of competition in demand. Even relatively orthodox marginalists such as John Bates Clark believed that economic value was a social rather than individual concept.⁶⁴ Progressives generally believed that this social conception was implicit in marginalism, and that it separated their approach to economics from the work of the classicists in the first half of the nineteenth century.

POL. ECON. 1, 14-17 (1957). For a rather extreme statement, see Richard A. Epstein, *Hayekian Socialism*, 58 MD. L. REV. 271 (1999).

63. See *infra* notes 129-37 and accompanying text (discussing ordinalism and progressive welfare economics).

64. See JOHN BATES CLARK, *THE PHILOSOPHY OF WEALTH* 10-20, 37, 61-63 (1887). In comparison, see the thought of British institutionalist economist John A. Hobson in *ECONOMICS OF DISTRIBUTION* (1900) and *ECONOMICS AND ETHICS: A STUDY IN SOCIAL VALUES* (1929).

A neoclassicist in the post-New Deal era might view the Progressive theory of social value as an unusually expansive theory of public goods, or goods that will not be produced in the correct amount if all production is left to individual market choice. But the theory of public goods does not capture the Progressive conception of social value. Even under public goods theory, value must be measured from the perspective of individual choice, a proposition that many Progressives rejected.

Columbia University's E.R.A. Seligman, a leading Progressive proponent of law and economics,⁶⁵ argued in 1901 that marginalist economics demonstrated that all values are social.⁶⁶ Classical political economy had generally tied value to the cost of production, which had no social component.⁶⁷ Marginalism, by contrast, located value in marginal willingness to pay, where value became dictated not only by how much the buyer was willing to pay, but by how much the buyer's competitors would have been willing to pay as well.⁶⁸ For example, in an auction market a bidder willing to pay \$100 might be able to purchase the good for \$10 if no one bid against him. But if the second highest bidder had been willing to pay \$90, then the winning bidder would end up paying some price between \$90 and \$100. "Value" was determined not merely by the winning bidder's preference, but by the joint preferences of market participants. In sum, transactions occur only when a seller regards a particular buyer's offer as better than anyone else's of

65. On Seligman's work on the theory of taxation and the progressive income tax, see Hovenkamp, *supra* note 18, at 1002-09.

66. See Edwin R.A. Seligman, *Social Elements in the Theory of Value*, 15 Q.J. ECON. 321, 322-27 (1901); see also IRVING FISHER, *MATHEMATICAL INVESTIGATIONS IN THE THEORY OF VALUE AND PRICES* 89 (1965 ed.) (1892); SIMON PATTEN, *ESSAYS IN ECONOMIC THEORY* 192 (R. Tugwell ed., 1924); John H. Gray, *Economics and the Law*, 5 AM. ECON. REV. 3, 20-23 (Supp. 1915) (arguing that policy economics should be concerned with group needs rather than individual preferences); D.I. Green, *Value and Its Measurement*, 7 YALE REV. 383 (1899); cf. Sidney Sherwood, *The Philosophical Basis of Economics, A Word to the Sociologists*, 10 ANNALS AM. ACAD. POL. & SOC. SCI. 206, 207 (1897) (arguing that the sociologists' theory of value, as presently developed, was too imprecise to be used by economists). For a recap of the debate, see Jacob Viner, *The Utility Concept in Value Theory and Its Critics: II. The Utility Concept in Welfare Economics*, 33 J. POL. ECON. 638 (1925).

67. Indeed, its lack of a social component caused some diehard classicists to continue to defend classical theories of value against the marginalist onslaught. See generally Silas M. Macvane, *Analysis of Cost of Production*, 1 Q.J. ECON. 481, 483 (1887); Silas M. Macvane, *Marginal Utility and Value*, 7 Q.J. ECON. 255 (1893).

68. See Seligman, *supra* note 66, at 322-23.

fer, and the buyer regards the seller's offer as better than that of other sellers.

For Progressives such as Seligman, the value determination process was social in a second important sense, as well. The individual utility curve itself was thought to be a product of socialization. Each buyer determines his or her own willingness to pay by comparing the willingness to pay of other individuals. This point was practically regarded as a truism that flowed from the Progressives' commitment to the theory of evolution. Since human beings are all of the same species and occupy similar environmental niches, basic elements in the utility curve are common to the entire class. Further, these basic elements were more important than more marginal elements, because the basic elements were more directly related to survival.

For example, Seligman justified the Progressive income tax by dividing goods into necessities, comforts, and luxuries. A progressive tax scheme that taxed away one person's luxuries to procure another's necessities increased social welfare.⁶⁹ Thorstein Veblen believed scarce goods such as penicillin should be thought of as having a social value that was quite different than any sum of individual values placed on it by those who needed it.⁷⁰ If human utility curves reflect the instinct for survival but wealth is maldistributed, then in an unregulated market the wealthier people's non-survival wants are satisfied before the poorer person's survival wants are. To say that penicillin has a social value greater than the sum of individual values was merely to say that the state should see to it that enough was produced to satisfy everyone's survival needs, not merely the amount that a market of willing buyers would purchase. Finally, if human utility curves are a product of the evolutionary process and reducible to the instinct for survival, then sociology and psychology can contribute to economics by studying the source and nature of preference.⁷¹

69. See Edwin R.A. Seligman, *The Theory of Progressive Taxation*, PUBLICATION AM. ECON. ASSN, Jan. 1893, at 52; Seligman, *supra* note 50, at 132-33. For fuller discussion, see Hovenkamp, *supra* note 18, at 1002-05.

70. See THORSTEIN VEBLEN, *Industrial and Pecuniary Employments*, in THE PLACE OF SCIENCE IN MODERN CIVILIZATION AND OTHER ESSAYS 298, 307-11 (1919).

71. See, e.g., Walton Hamilton, *The Institutional Approach to Economic Theory*, 9 AM. ECON. REV. 309, 316 (Supp. 1919) (arguing for a "theory of motives . . . in harmony with the conclusions of modern social psychology"); Wesley C. Mitchell, *Human Behavior and Economics: A Survey of Recent Literature*, 29 Q.J.

The concept of a "social" value rested on the premise that interpersonal comparisons of utility were possible and even conventional within economics. Indeed, interpersonal utility comparisons were hardly foreign to neoclassical economics, and dominant figures such as Marshall and Pigou in England, Clark, Taussig, Patten, and even Chicago's Jacob Viner engaged in them through the 1920s.⁷² Clark's son, John Maurice Clark, argued that a complete economics would include both the "science" of observing preferences and developing mathematically the consequences of marginal utility theory; but also the "art" of examining the social sources of preference.⁷³ For Clark, this entailed the use of more objective welfare tests, drawn from behavioral psychology or sociology.⁷⁴ Princeton's

ECON. 1, 2 (1914) (criticizing the view that economic theory rests "upon the simple facts of preference or choice, and the psychological explanation of these preferences or choices is . . . a matter of indifference to our science"); Wesley C. Mitchell, *The Rationality of Economic Activity I*, 18 J. POL. ECON. 97, 103, 109-13 (1910) (taking issue with the economist's supposition of the rationality of human action and arguing that psychology and sociology suggested the contrary).

72. See MARSHALL, *supra* note 41, at 18-19 (arguing that a pound's worth of satisfaction to an ordinary poor man is a much greater thing than a pound's worth of satisfaction to an ordinary rich man); ARTHUR C. PIGOU, *ECONOMICS OF WELFARE* 89 (4th ed. 1960) (arguing that "[a]ny transference of income from a relatively rich man to a relatively poor man of similar temperament, since it enables more intense wants to be satisfied at the expense of less intense wants, must increase the aggregate sum of satisfaction"); FRANK WILLIAM TAUSSIG, *PRINCIPLES OF ECONOMICS* 132 (3d ed. 1921) ("The principle of diminishing utility, if applied unflinchingly, leads to the conclusion that inequality of incomes brings a less sum of human well-being than equality of incomes, and that the greater the inequality, the less the approach to the maximum."); John Bates Clark, *The Ultimate Standard of Value*, 1 YALE REV. 258 (1893) (arguing that social welfare is a function of aggregated individual utilities); Simon N. Patten, *The Scope of Political Economy*, 2 YALE REV. 264, 266 (1894) (arguing that homogeneity of wealth and property tends to increase total utility); Viner, *supra* note 66, at 644 (1925) ("Changes in the relative distribution of income as between different classes will bring about changes in the amount of welfare, even though the aggregate real income of the community remains the same.").

73. See generally John Maurice Clark, *Economic Theory in an Era of Social Readjustment*, 9 AM. ECON. REV. 280 (Supp. 1919); John Maurice Clark, *Economics and Modern Psychology*, 26 J. POL. ECON. 1, 7 (1918) [hereinafter Clark, *Economics and Modern Psychology*].

74. See John Maurice Clark, *The Concept of Value: A Rejoinder*, 29 Q.J. ECON. 709, 712 (1915); see also Clark, *Economics and Modern Psychology*, *supra* note 73, at 10 ("In proportion as scientific research progresses, minimum standards of welfare will become more and more matters of social knowledge and less and less matters of individual taste—but only minimum standards relating to those necessities which are generally accepted as such."); Lawrence K. Frank, *The Emancipation of Economics*, 14 AM. ECON. REV. 17 (1924); A.J. Snow, *Psychology in Economic Theory*, 32 J. POL. ECON. 487 (1924).

Frank Fetter argued that economists should distinguish "price economics" from "welfare economics"—the former based on subjective individual market choice, the latter based on objective standards of value drawn from observations of group behavior.⁷⁵ Yale's Irving Fisher believed that by using statistics and empirical data one could construct averaged utility curves for earners of different income levels, thus permitting policy-makers to construct an optimal progressive income tax.⁷⁶ Wesley Mitchell likewise argued that while social welfare was a "rather vague" concept, it was nonetheless "capable of being made objective and definite in reference to such matters as food, clothing, shelter, sanitation, education, fatigue, leisure."⁷⁷

The concept of social value promised to unify neoclassical economics with the other sciences. Simon Patten, an economist who wrote about sociology, believed that the key to understanding economics was consumption, and that consumption patterns are socially conditioned. As a result, sociology and economics should become a single science.⁷⁸

Edward A. Ross, a sociologist who also wrote about marginalist economics, stressed that value is entirely a function of social conditioning. *Social Control*, his most important contribution to sociology, was an extended argument that values are socially formed, that individual selfishness is in constant tension with social institutions, and that the principal task of sociology is to study the tension between individual instincts and social conditioning.⁷⁹ At the same time, however, Ross realized that "value" was ultimately an individual assertion of preference. He concluded that social value occurs because influential individuals place a value on something, and the rest of society then copies them.⁸⁰ Further, social values are a product of the

75. See Frank A. Fetter, *Price Economics Versus Welfare Economics*, 10 AM. ECON. REV. 467, 476-79 (1920).

76. See Irving Fisher, *A Statistical Method for Measuring "Marginal Utility" and Testing the Justice of a Progressive Income Tax*, in ECONOMIC ESSAYS CONTRIBUTED IN HONOR OF JOHN BATES CLARK 157, 171 (H. Hollander ed., 1927).

77. Jacob Wesley Clair Mitchell, *The Prospects of Economics*, in THE TREND OF ECONOMICS 1, 31 (Rexford Guy Tugwell ed., 1924).

78. See Simon N. Patten, *The Effect of the Consumption of Wealth on the Economic Welfare of Society*, in SCIENCE ECONOMIC DISCUSSION 123 (Henry C. Adams ed., 1886); Simon N. Patten, *The Failure of Biologic Sociology*, 4 ANNALS AM. ACAD. POL. & SOC. SCI. 919 (1894); Simon N. Patten, *The Relation of Economics to Sociology*, 5 ANNALS AM. ACAD. POL. & SOC. SCI. 577 (1895).

79. ROSS, *supra* note 30.

80. See *id.* at 329.

evolutionary process, as are all physical and cultural characteristics of humanity. Social values that fail are forgotten, while those that seem to enrich their societies or make them safer are copied and become more firmly entrenched in social mores, eventually rising to the status of national moral or religious values.⁸¹ For example, over-aggressive sexuality never acquires a high social value because, notwithstanding that many individuals desire it intensely, it leads to social disruption.⁸² "[T]he valuations we are bred to are not native to us,"⁸³ Ross wrote. He then located "the genesis of ethical elements" in the twin evolutionary processes of "selection and survival."⁸⁴ In sum, our habits, practices and even our desires are the product of evolutionary process as much as our physical characteristics.

1. Social Value and Human Capital

These views about the nature of value anticipated the economic concept of "human capital," which views the human utility function as a kind of production function.⁸⁵ If we look at human beings principally as producers rather than consumers, then we can make more categorical social judgments about value. Just as aluminum plants need labor, electricity and bauxite in a certain combination to operate, so too human beings need shelter, food and education. Indeed, if we begin with the premise that all human production "plants" are more or

81. See *id.* at 330.

82. See *id.* at 331.

83. *Id.* at 332.

84. *Id.* at 338-39. Ross illustrated:

There were many styles of gold-washing on the Sacramento in 1849; but one style was gradually found to be more convenient than the others, and became after a while the standard way of washing out gold, which newcomers adopted as a matter of course. A like weeding out of inferior individual practices brings to light a standard form of pot or tool or weapon, a standard mode of tilling or breeding, a standard sex relation or education of the young, which is uniform for all, possesses authority, and may be termed a *culture element*. . . .

Once an element has emerged triumphant from this rivalry, it becomes fixed in custom and remains thus shielded from competition, until, perhaps, it is confronted with a different practice or belief that has won the favor of some other group. Then deadly comparisons are made, and weeding out begins again.

Id.

85. See generally GARY S. BECKER, *THE ECONOMIC APPROACH TO HUMAN BEHAVIOR* (1976); GARY S. BECKER, *HUMAN CAPITAL* (3d ed. 1993); GARY S. BECKER, *A TREATISE ON THE FAMILY* (rev. ed. 1991).

less the same, then we can determine objectively the optimum mixture of inputs that would lead them to perform efficiently.⁸⁶

Furthermore, the theory of human capital measures value by using the willingness of *others* to pay as a surrogate for one's own willingness to pay. That is to say, human capital defines the satisfaction of individual wants in terms of the impact that goods have on an that individual's productivity. But the value of production is entirely a function of the potential buyers' willingness to pay. So when we measure the utility that A receives from a weekly gallon of milk by noting that it improves his productivity by \$5 per week, we in effect are observing that when A receives a weekly gallon of milk others are willing to pay \$5 per week more for A's output. This approach forms a kind of bridge over the problem of the interpersonal noncomparability of utilities.

The Progressive conception of social value and the human capital thesis have in common that, while they do not disregard the role of individual preference in welfare, they use surrogates for estimating the content of preference. The starting point for the surrogate is the idea that the neoclassical utility function is nothing more than the evolving organism's instinct for survival, which is in itself a kind of production function: the organism produces what it needs to survive. Further, as evolving organisms developing in similar environments, human beings' survival needs are similar. Finally, the "instinct" for survival entails that survival needs rank higher in any preference ordering than do secondary preferences, or decisions about how to allocate one's surplus. Human capital accounts for this concept in terms that are more familiar to the economist by taking advantage of the neoclassical literature on the business firm, which views productivity as the analogue of preference, and profit-maximization as the analogue of utility maximization.⁸⁷ As a result, productivity, unlike utility, can be quantified and compared by the external observer.

The damning neoclassical critique of interpersonal utility comparisons chose not to regard this point as relevant.⁸⁸ By

86. See Herbert Hovenkamp, *The Limits of Preference-Based Legal Policy*, 89 NW. U. L. REV. 4, 84-90 (1994).

87. See *id.*

88. See, e.g., LIONEL ROBBINS, AN ESSAY ON THE NATURE AND SIGNIFICANCE OF ECONOMIC SCIENCE (2d ed. 1935); see also Robert Cooter & Peter Rappoport, *Were the Ordinalists Wrong About Welfare Economics?*, 22 J. ECON. LIT. 507 (1984); Hovenkamp, *supra* note 18, at 1033-47.

separating the utility function from its evolutionary origin and divorcing utility from productivity, the ordinalist economists viewed individuals' utility functions as if they had no more than random relationships with one another. Utility became nothing more than states of mind about desires. In that case, the noncomparability of utilities necessarily follows. But in the process of making their critique, the ordinalists shifted the premises considerably and unnecessarily made the science of economics a much less useful tool than it might otherwise have been.⁸⁹

2. Social Value in the Thought of Roscoe Pound

The legal scholar who benefited most directly from Edward Ross's work on social value theory was Roscoe Pound. The two men became friends at the University of Nebraska just after the turn of the twentieth century, and by all accounts Ross was the inspiration for Pound's vision of the melding of legal policy and social science that Pound later called "sociological jurisprudence."⁹⁰ Pound's early writing relied on Ross as well as other social scientists. He was concerned about outmoded legal rules, using substantive due process, or liberty of contract, as his principal example.⁹¹ He believed that although legal use of the term "liberty of contract" was relatively recent, the individualistic bias of liberty of contract doctrine actually originated with the classical political economists—mainly, Adam Smith, David Ricardo, and John Stuart Mill.⁹² Pound argued that classical economics had given the law an individualistic bias that ignored the social aspects of value inherent in the social sciences, particularly sociology. According to Pound's biographer, Pound was particularly influenced by Ross's *Sin and*

89. See discussion *infra* text accompanying notes 129-37.

90. See DAVID WIGDOR, ROSCOE POUND 111-14 (1974). Pound needs a new biography that is somewhat more critical, that explores more deeply the intellectual origins of Pound's pre-1930s thought, and that evaluates more fully Pound's 1930s relationship with the Legal Realists.

91. See, e.g., Roscoe Pound, *Liberty of Contract*, 18 YALE L.J. 454 (1909) [hereinafter Pound, *Liberty of Contract*]; Roscoe Pound, *Mechanical Jurisprudence*, 8 COLUM. L. REV. 605 (1908) [hereinafter Pound, *Mechanical Jurisprudence*].

92. See Pound, *Liberty of Contract*, *supra* note 91, at 455-56. Pound relied for his critique of the classicists on HENRY ROGERS SEAGER, INTRODUCTION TO ECONOMICS (3d ed. 1907), replaced in later years by his more influential PRINCIPLES OF ECONOMICS (1913). Seager was trained in the German Historical School but was a fairly orthodox marginalist and among the more conservative of the Progressive economists.

Society,⁹³ in which Ross argued that the country's numerous moral dilemmas had social rather than individual roots.⁹⁴

For his ideas of social value, however, Pound placed little obvious reliance on the English and American utilitarians or marginalists.⁹⁵ Pound, as many other Progressive Era scientists, drew much of his social value theory from the German historical tradition.⁹⁶ Pound was particularly indebted to Rudolf von Jhering, a mid-nineteenth century German legal historian who had attempted to modify extreme German historicism by making its theory of change less metaphysical and more Darwinian.⁹⁷ If one can judge from citations, Pound's "sociological jurisprudence" owes much more to the German Historical School and the reaction against it than to the British economic tradition.⁹⁸

Nineteenth century German historical scholarship was strongly nationalistic, institutionalist, and had little conception of individual autonomy. One impact of Pound's German attachment is that individual preference plays little role in his social theory.⁹⁹ "Social interests," insofar as Pound articulated

93. EDWARD ALSWORTH ROSS, *SIN AND SOCIETY* (1907).

94. See WIGDOR, *supra* note 90, at 113.

95. Pound cited SEAGER, *supra* note 92, and the work of other Progressive Era sociologists, including EDWARD A. ROSS, *SOCIAL PSYCHOLOGY* (1908), *cited in* Pound, *Mechanical Jurisprudence*, *supra* note 91, at 607 n.7; LESTER FRANK WARD, *APPLIED SOCIOLOGY* (1906), *cited in* Pound, *Liberty of Contract*, *supra* note 91, at 454 n.3.

96. On the influence of the German Historical School on Progressive Era American scholarship, see JURGEN HERBST, *THE GERMAN HISTORICAL SCHOOL IN AMERICAN SCHOLARSHIP* (1965). On Pound and German historicism and the German "free law" movement, which sought to identify "social interests" that the law should protect, see James E. Herget & Stephen Wallace, *The German Free Law Movement as the Source of American Legal Realism*, 73 VA. L. REV. 399, 422-28 (1987). On the German historical school and legal thought generally, see *id.* at 405-06.

97. See, e.g., RUDOLF VON JHERING, *LAW AS A MEANS TO AN END* 332-33 (Isaac Husik trans., 1913). On Jhering's influence on Pound, see Herget & Wallace, *supra* note 96, at 407-10; WIGDOR, *supra* note 90, at 114-18.

98. See, e.g., Roscoe Pound, *Legislation as a Social Function*, 18 AM. J. SOC. 755, 762 (1913); Roscoe Pound, *Making Law and Finding Law*, 82 CENTRAL L.J. 351, 358 (1916); Roscoe Pound, *The Scope and Purpose of Sociological Jurisprudence* (pts. 1-3), 24 HARV. L. REV. 591 (1911), 25 HARV. L. REV. 140 (1912), 25 HARV. L. REV. 490 (1912) [hereinafter Pound, *Scope and Purpose*]; Roscoe Pound, *Social Problems and the Courts*, 18 AM. J. SOC. 331, 341 (1912).

99. However, later in his career Pound moved to the right and objected to what he saw as Legal Realism's use of the social sciences to subordinate all concern for the individual to various question about public goods and values. See generally, e.g., Roscoe Pound, *Public Law and Private Law*, 24 CORNELL L.Q. 469

them, were things to be discovered by social scientists, and Pound had a rather technocratic view about social science methodology. He seemed to think that sociologists and psychologists simply knew what was best for people. Even his theory of legislation has the ideal legislator largely ignoring the choices of his constituency. Rather, the legislator's job is to do the right thing, and the right thing is invariably dictated by social science inquiry. At the same time, Pound never paid much attention to economics.¹⁰⁰ For him, the social sciences in "sociological jurisprudence" were mainly the disciplines of sociology, psychology, and political science. In sum, Pound's legal theory was certainly one of the most non-individualistic theories to be developed by a high profile thinker associated with an elite American legal institution.¹⁰¹ His thought was fundamentally inimical to neoclassical economic analysis, although it fit in quite well with the institutional economics of the early decades of the twentieth century.

B. THE CRISIS OF MARGINALIST THEORY

An initial consequence of marginalism was the development of a dialogue in which academic economists and legal theorists saw themselves as engaged in a common intellectual enterprise that included the other social sciences as well.¹⁰² Progressives seized upon important conceptions that seemed inherent in the new economics: its belief that markets often work poorly, that wealth transfers could increase social welfare, and that commodities have a social value that may be more important for policy purposes than the values assigned by the market.¹⁰³ Marginalism for a time seemed to turn economics into a Darwinian social science. This provided Progressive intellectuals with an opportunity to link law and the social sci-

(1939).

100. Pound seems hostile toward economics as a general matter, and generally understood "economics" in legal analysis to refer to interest group politics. See, e.g., Roscoe Pound, *The Economic Interpretation and the Law of Torts*, 53 HARV. L. REV. 365, 383 (1940) (identifying the "economic interpretation" as the theory of how the rise and fall of various economically or politically powerful interests explains changes in tort law, and then arguing that such analysis accounts for only a small part of the law of torts).

101. See, e.g., Pound, *Scope and Purpose* (pt. 3), *supra* note 98, at 489, 516 (listing the characteristics of Sociological Jurisprudence).

102. See generally Hovenkamp, *supra* note 18.

103. See, e.g., John R. Commons, *Law and Economics*, 34 YALE L.J. 371, 374 (1925).

ences, including economics, creating a valuable set of tools for state policy-making.

After the 1910s, economists became increasingly skeptical, indifferent and eventually hostile toward concepts of social value—or to any concept of value that could not be defined strictly in terms of individual preference. For most neoclassical economists the question was not whether individual utility functions have social origins. Most either conceded that they did or else had nothing to say about the matter. Rather, the important issue was whether the study of the social origins of preference ought to be a part of economics. Broadening the inquiry softened the scientific status of their discipline. The hard mathematics of marginal utility economics applied to the *consequences* of a set of preferences assumed as both given and stable. For example, the developing models of competition and welfare economics assumed a set of relatively durable individual preferences and then measured the consequence of transactions that could be shown to occur anytime the prospective buyer valued a good by more than the prospective seller.¹⁰⁴ By contrast, study of the social sources of preference exposed economics to far mushier, less tractable questions that mainstream neoclassicists preferred be relegated to the other social sciences. Essentially, economists were much more concerned about distinguishing their methodology rather than unifying their discipline with sociology, psychology or political science.

Sociologists and psychologists wanted just the opposite. They tended to see inquiries into the source of preference as the key to a unified scientific method. Edward Ross argued that what one person is willing to pay for a commodity is driven in large part by his perception of what others are willing to pay for it.¹⁰⁵ As a result, economists must become much more involved in sociological questions about the nature and source of preference.¹⁰⁶ John Dewey continued to argue as late as 1930 that social value was as important to economics as individual value, and that studies of the relationship between the two promised to unify psychology and economics. Dewey presaged the theory of human capital by arguing that the economic concept of marginal value was scientifically meaningful only if de-

104. See generally Stigler, *supra* note 62.

105. See generally Edward Ross, *The Sociological Frontier of Economics*, 13 Q.J. ECON. 386 (1898).

106. See *id.* at 394.

defined as the capacity of a good to make a person a productive member of society.¹⁰⁷

For the neoclassicists, marginalism's promised mathematical precision could be realized only if economics abandoned both its evolutionary commitments and its search for social conceptions of value. The mathematics of preference could deal only with the assumptions that preferences were stated and ranked. Adding information about where preferences came from or how they related to productivity was not only irrelevant, but it made mathematical manipulation of utility functions intractable. Thus, the utility curve of neoclassical welfare economics began to rely on an unprecedented and extraordinarily narrow set of assumptions about what constitutes scientific knowledge of welfare.

Legal theory generally followed sociology and psychology rather than the economists. As a result, beginning in the 1930s, economic theory became marginalized within progressive legal theory, and the economics used by elite legal theorists moved increasingly to the periphery of economic theory generally. By the 1930s and 1940s, the economics of legal theory was thoroughly institutionalist, long after institutionalism had fallen into disfavor in economic circles.¹⁰⁸ By contrast, "welfare" economics, whose concerns were often thought by neoclassicists to lay at the boundaries of economics, became increasingly neoclassical and hostile to the redistributive elements in the policy agenda of the progressive Legal Realists and the New Deal. Neoclassical welfare economists generally believed that any policy of state distribution could be justified only by political considerations and value judgments, but not by economic science.¹⁰⁹

107. See JOHN DEWEY, *INDIVIDUALISM, OLD AND NEW* 9, 135, 168-71 (1930); John Dewey, *Theory of Valuation*, in 2 *INTERNATIONAL ENCYCLOPEDIA OF UNIFIED SCIENCE* 19-50 (1930). Compare the work of Clarence Ayres, a younger Progressive who did not start writing until the 1940s but then became a prominent dissenter from neoclassicism. Ayres also believed that one could measure social value through productivity tests—for example, conducting experiments on the importance of milk for infants and then coming up with a social value function that would inform the state policymaker about how many resources should be committed to guaranteeing its availability. See CLARENCE E. AYRES, *THE INDUSTRIAL ECONOMY* 305 (1952).

108. See *infra* notes 151-95 and accompanying text.

109. See, e.g., GUNNAR MYRDAL, *THE POLITICAL ELEMENT IN THE DEVELOPMENT OF ECONOMIC THEORY* 102 (1953). See generally I.M.D. LITTLE, *CRITIQUE OF WELFARE ECONOMICS* (1950); J.R. Hicks, *The Foundations of Welfare Economics*, 49 *ECON. J.* 696 (1939); Nicholas Kaldor, *Welfare Propositions of*

1. The Critiques of Veblen and Schumpeter

This divorce of law and economics was facilitated by the thought of two important outsiders to the neoclassical tradition, Thorstein Veblen¹¹⁰ and Joseph Schumpeter.¹¹¹ Although they viewed economics from vastly different perspectives, they came to surprisingly similar and influential conclusions about the relationship between economics and the social sciences. The insight that Veblen and Schumpeter presented in such radically different ways was that the neoclassical concept of the marginal utility curve could refer only to the preferences of individuals. To speak of group preferences was meaningless. For Veblen, this entailed that the concept of marginal utility itself be reconstituted so that economics could become a more "evolutionary" and social science. For Schumpeter, it entailed that economics abandon its evolutionary concern with "social" values and stick to its orthodox business of measuring the choices made by individuals. Eventually, economics followed Schumpeter, while the law and other social sciences generally followed Veblen.¹¹²

a. *Veblen: Evolution, Marginal Utility, and Institutions*

Veblen was Progressive economics' most influential outsider. Not only was he an outsider to the numerous educational institutions with which he was briefly associated, he was also an outsider to the theory. He wrote more as a critical, transcendent observer than as a participant in any group enterprise. Reading him is frustrating. Although Veblen's best prose is brilliant, his discursive style often makes the main point hard to find.

Economics and Inter-personal Comparisons of Utility, 49 ECON. J. 549 (1939).

110. On Veblen, see LEONARD DENTE, *VEBLEN'S THEORY OF SOCIAL CHANGE* (1977); JOSEPH DORFMAN, *THORSTEIN VEBLEN AND HIS AMERICA* (1934); STEPHEN EDGEELL, *VEBLEN: SOCIAL THEORIST AND SOCIAL CRITIC* (1987); J.A. HOBSON, *VEBLEN* (1937); DAVID RIESMAN, *THORSTEIN VEBLEN* (1953); DAVID SECKLER, *THORSTEIN VEBLEN AND THE INSTITUTIONALISTS* (1975); BEN B. SELIGMAN, *MAIN CURRENTS IN MODERN ECONOMICS* 129-58 (1962).

111. On Schumpeter, see RICHARD SWEDBERG, *SCHUMPETER: A BIOGRAPHY* (1991).

112. See generally *supra* notes 110-11. Both Veblen and Schumpeter also criticized the importance that neoclassicism assigned to the concept of an equilibrium. Both believed that the essence of markets and exertions of preference is change, and that the study of change was far more important than the study of equilibrium.

Veblen's conception of economics and markets was that human beings act according to "habits" that account for all of human behavior and whose characteristics are formed by evolution.¹¹³ Veblen used "habits" in roughly the same sense that neoclassical welfare economists use "preferences." The importance of evolution was, first, that these habits were continually changing; second, they were the product of a complex interaction between the environment and the individual organism seeking survival.¹¹⁴ As a result, these habits differed insofar as nature produced variation, but they were the same insofar as the natural selection process chose certain classes of habits for survival. Veblen, the father of American institutionalism, then added that institutions were nothing more than those "settled habits of thought common to the generality of men."¹¹⁵ In common with Darwinism but hardly with neoclassical economics, Veblen believed that human "reasoning is largely controlled by other than logical, intellectual forces; . . . and the sentiment which animates men, singly or collectively, is as much, or more, an outcome of habit and native propensity as of calculated material interest."¹¹⁶ Veblen found the neoclassical conception of preferences to be fundamentally flawed because it made no inquiry into the evolutionary source of habits, but simply took preferences as given.¹¹⁷

Veblen thus rejected the entire neoclassical notion that human beings are economic actors with a set of stable, gener-

113. See GEOFFREY MARTIN HODGSON, *ECONOMICS AND EVOLUTION* (1993); Stephen Edgell, *Thorstein Veblen's Theory of Evolutionary Change*, 34 AM. J. ECON. & SOC. 267 (1975).

114. See generally Charles G. Leathers, *Veblen and Hayek on Instincts and Evolution*, 12 J. HIST. ECON. THOUGHT 162 (1990).

115. Thorstein Veblen, *The Limitations of Marginal Utility*, 17 J. POL. ECON. 620, 626 (1909); see also Richard N. Langlois, *What Was Wrong with the Old Institutional Economics? (And What Is Still Wrong with the "New"?)*, 1 REV. POL. ECON. 3 (1989).

116. Thorstein Veblen, *The Socialist Economics of Karl Marx and His Followers*, 21 Q.J. ECON. 299, 308 (1907).

117. See Veblen, *supra* note 115, at 627.

To any modern scientist interested in economic phenomena, the chain of cause and effect in which any given phase of human culture is involved, as well as the cumulative changes wrought in the fabric of human conduct itself by the habitual activity of mankind, are matters of more engrossing and more abiding interest than the method of inference by which an individual is presumed invariably to balance pleasure and pain under given conditions that are presumed to be normal and invariable.

ally autonomous preferences who trade toward an equilibrium.¹¹⁸ He also rejected the view that the source of preferences is completely exogenous to the neoclassical system. Rather, economics should study the habits that yield human preferences, and the changes that occur in them, and not merely seek to divine what the equilibrium condition would be after settled individual preferences have been exercised in the market.¹¹⁹ Equilibrium was rather unimportant to any general theory of economics because the structure of human habit was always the result of interaction of human variation and the environment, and continuously subject to evolutionary change.¹²⁰ This set of concerns characterizes Veblen's approach as "institutionalist" and serves to set him apart from the mainstream neoclassicism which rejected institutionalism in the 1920s.¹²¹

Veblen's Darwinism enabled him to speak of societies—or, more specifically, of institutions—as economic participants. Just as human individuals compete in a struggle for existence, so too do the institutions that human beings form:

The evolution of social structure has been a process of natural selection of institutions. The progress which has been and is being made in human institutions and in human character may be set down, broadly, to a natural selection of the fittest habits of thought and to a process of enforced adaptation of individuals to an environment which has progressively changed with the growth of the community and with the changing institutions under which men have lived. Institutions are not only themselves the result of a selective and adaptive process which shapes the prevailing or dominant types of spiritual attitude and aptitudes; they are at the same time special methods of life and of human relations, and are therefore in their turn efficient factors of selection. So that the changing institutions in their turn make for a further selection of individuals endowed with the fittest temperament, and a further adaptation of individual temperament and habits to the changing environment through the formation of new institutions.¹²²

118. See Thorstein Veblen, *Why Is Economics Not an Evolutionary Science?*, 12 Q.J. ECON. 373 (1898); see also Thorstein Veblen, *The Preconceptions of Economic Science* (pt. 3), 14 Q.J. ECON. 240 (1900); Thorstein Veblen, *Professor Clark's Economics*, 22 Q.J. ECON. 147 (1908).

119. On this point, see Geoffrey M. Hodgson, *Thorstein Veblen and Post-Darwinian Economics*, 16 CAMBRIDGE J. ECON. 285, 292 (1992).

120. See THORSTEIN VEBLEN, *The Evolution of the Scientific Point of View*, 10 UNIV. CAL. CHRON. (n.d.), reprinted in *THE PLACE OF SCIENCE IN MODERN CIVILIZATION AND OTHER ESSAYS* 32, 37 (Transaction Publishers 1990) (1919).

121. See *infra* notes 151-61 and accompanying text.

122. THORSTEIN VEBLEN, *THE THEORY OF THE LEISURE CLASS* 131 (Houghton Mifflin Co. 1973) (1899); see also Malcolm Rutherford, *Thorstein Veblen and the Processes of Institutional Change*, 16 HIST. POL. ECON. 331 (1984); Rick Tilman,

b. Schumpeter: Methodological Individualism and the Attack on Social Value

If individuals do not have precisely identical preferences, and if the differences are not precisely knowable, then one can apply the mathematics of marginalism only to individuals. This observation, modest but revolutionary, appeared in one of Joseph Schumpeter's early English contributions to economic thought, written in Vienna long before he immigrated to the United States.¹²³ As a result, Schumpeter argued, if economics hopes to acquire anything approaching scientific precision of statement it must adopt "methodological individualism" as a working procedure.¹²⁴ Schumpeter then insisted that this move would not require the economist to take any position on the

Some Recent Interpretations of Thorstein Veblen's Theory of Institutional Change, 21 J. ECON. ISSUES 683 (1987).

123. See generally Joseph A. Schumpeter, *On the Concept of Social Value*, 23 Q.J. ECON. 213 (1909). A year earlier he had published *DAS WESEN UND HAUPTINHALT DER THEORETISCHEN NATIONALÖKONOMIE* (1908) [NATURE AND ESSENCE OF THEORETICAL ECONOMICS], which was never translated.

124. Schumpeter's writing was stark and to the point:

At the outset it is useful to emphasize the individualistic character of the methods of pure theory. Almost every modern writer starts with wants and their satisfaction, and takes utility more or less exclusively as the basis of his analysis. Without expressing any opinion about this *modus procedendi*, I wish to point out that, as far as it is used, it unavoidably implies considering individuals as independent units or agencies. For only individuals can feel wants. . . . [M]arginal utilities do not depend on what society as such has, but on what individual members have. Nobody values bread according to the quantity of it which is to be found in his country or in the world, but everybody measures the utility of it according to the amount that he has himself, and this in turn depends on his general means.

Schumpeter, *supra* note 123, at 214.

On methodological individualism in economics, see MARK BLAUG, *THE METHODOLOGY OF ECONOMICS* 129-56, 227-31 (1980); RANDALL G. HOLCOMBE, *ECONOMIC MODELS AND METHODOLOGY* 57-69 (1989). On methodological individualism in law and economics, and its relation to interpersonal utility comparisons, see generally Gary Lawson, *Efficiency and Individualism*, 42 DUKE L.J. 53 (1992). Methodological individualism in philosophy and the other social sciences long antedates Schumpeter, although it was not much debated during the Progressive Era. See generally Leon J. Goldstein, *The Inadequacy of the Principle of Methodological Individualism*, 53 J. PHIL. 801 (1956); Steven Lukes, *Methodological Individualism Reconsidered*, 19 BRIT. J. SOC. 119 (1968); Maurice Mandelbaum, *Societal Facts*, 6 BRIT. J. SOC. 305 (1955); Richard Miller, *Methodological Individualism and Social Explanation*, 45 PHIL. SCI. 387 (1978); J.W.N. Watkins, *Historical Explanation in the Social Sciences*, 8 BRIT. J. PHIL. SCI. 104 (1957); J.W.N. Watkins, *Ideal Types and Historical Explanation*, 3 BRIT. J. PHIL. SCI. 22 (1952).

fundamental question whether values are in some sense "social" as well as individual.

Schumpeter's observation was of course true as a purely technical matter. If we need to know the precise ratio in which Smith will buy food and opera tickets, and if Smith's asserted preferences are observed to differ from the preferences of others, then precise quantification of Smith's choices will not accurately describe the choices made by someone else. Further, "[s]ociety as such, having no brain or nerves in a physical sense, cannot feel wants and has not, therefore, utility curves like those of individuals."¹²⁵ Economic welfare must be determined by individual preferences. Outside of a communistic society—by which he apparently meant a society having no markets at all—the concept of "social" value was meaningless.

In sharp distinction to Veblen, as well as other Progressive Era economists, Schumpeter also concluded that no insights useful for economics could be gleaned by examining the sources of human preference and welfare. "For theory it is irrelevant *why* people demand certain goods: the only important point is that all things are demanded, produced, and paid for because individuals want them."¹²⁶ This conclusion defined the differences between Veblen and Schumpeter, and also between Progressive and neoclassical policy science. Considered for its value to economics, the study of human evolution was an inquiry into the *source* of human welfare and preference, and an attempt to classify and weigh preferences by studying adaptation and survival. Once neoclassicism took Schumpeter's suggestion that inquiries into the source of preference were not a part of economics, then it did not matter whether human beings were the products of biological evolution or whether they had been placed on this earth in a single instant with their preferences fully formed and as unchangeable as the shapes of their ears. Neoclassical economics after the 1930s assumed the latter.

Schumpeter believed, as would nearly all neoclassical economists a generation later, that economics could maintain its scientific status only by confining its conclusions to what the data showed, and the kind of data that economists used provided evidence only of fully formed individual preferences.¹²⁷

125. Schumpeter, *supra* note 123, at 215.

126. *Id.* at 216.

127. See generally Frank H. Knight, *The Nature of Economic Science in Some Recent Discussion*, 24 AM. ECON. REV. 225 (1934).

Within this model, the concept of "social value," as some kind of amalgam of individual values, could never be more than a vague "analogy."¹²⁸

Schumpeter's observation served to alienate economics from the social sciences. The source of the division was that Schumpeter's was not the only way of formulating the problem. If the important question was the extent to which individual preferences differed, then Schumpeter was right. But if the question was whether the evolutionary process results in preferences that are sufficiently similar that one can draw useful generalizations about them, then social scientists in other disciplines believed they had plenty to offer, particularly to legal policymakers obsessed with Pragmatism and useful knowledge. Schumpeter's critique of the concept of social value, plus the later ordinalist critique of welfare economics, also separated the fundamental concerns of neoclassical economics from those of the other social sciences.

2. Ordinalism and the Death of Progressive Welfare Economics

The combination of marginalism and Darwinism gave Progressive policymakers a rationale for the redistribution of wealth. If money is subject to declining marginal utility, and if all persons are basically alike in their environmental needs and responses, then total welfare can be improved by transferring wealth from those who have much to those who have little.

Neoclassical economists in the 1930s argued that this justification for wealth transfers was unscientific because it rested on unverifiable assumptions; namely, that individual utility functions are identical or nearly so, and that the amount of utility that one individual receives from any unit of a good can be quantified and compared with the amount another receives from the same unit. Although we might know that A values her millionth dollar by much less than her first dollar, A may nevertheless value her millionth dollar by more than B values his first dollar. In that case, a forced wealth transfer from millionaire A to pauper B would be counterproductive.¹²⁹

128. See Schumpeter, *supra* note 123, at 220-22.

129. See ROBBINS, *supra* note 88, at 136-47. See generally Lionel Robbins, *Interpersonal Comparisons of Utility*, 48 ECON. J. 635 (1938). Schumpeter had already observed a generation before Robbins's essay:

A most interesting assumption would be that, at a given time and in a given place, individual utility curves for each commodity do not

Using exquisitely positivistic rhetoric,¹³⁰ Lionel Robbins observed that if B claimed to receive more utility from this dollar than A did, no one, including A or B, would be able to develop a test that would verify or falsify B's claim. Within the *au curren*t jargon of logical positivism,¹³¹ this made the proposition that B receives more utility from the marginal dollar than A does meaningless; statements that can be neither verified nor falsified have no meaning whatsoever.

As far as neoclassical economics was concerned, Robbins's analysis swept the field.¹³² However, the novelty of Robbins's observations should not be exaggerated. Some pre-ordinalist and even pre-neoclassical economists knew full well that subjective feelings could not be compared across persons. Even Jeremy Bentham had lamented that it was "in vain to talk of adding quantities which after the addition will continue distinct as they were before, one man's happiness will never be another man's happiness: a gain to one man is no gain to another; you might as well pretend to add 20 apples to 20 pears."¹³³ Nonetheless, Bentham concluded that although the "addibility of the happiness of different subjects . . . may appear fictitious," it was a proposition "without the allowance of which all political reasoning is at a stand."¹³⁴ By 1940, mainstream economists purported to abhor all interpersonal comparisons of utility. To make them became one of economics' most conspicuous indiscretions. Theoretical economics very largely abandoned the business of making policy proposals about the distribution of wealth.

differ very much from each other. To-day [sic] we do not assume anything of this sort, but fashion, imitation, etc., might support such an hypothesis, the importance of which it is needless to emphasize.

Schumpeter, *supra* note 123, at 219 n.2.

130. On the influence of scientific positivism on neoclassicism in the 1930s, see WILLIAM H. BEVERIDGE, *THE LONDON SCHOOL OF ECONOMICS AND ITS PROBLEMS, 1919-1937*, at 46-58 (1960).

131. See, e.g., ALFRED JULES AYER, *LANGUAGE, TRUTH AND LOGIC* 5-16 (1936).

132. See, e.g., LITTLE, *supra* note 109, at 55-58. See generally R.F. Harrod, *Scope and Method of Economics*, 48 *ECON. J.* 383 (1938); Hicks, *supra* note 109; Kaldor, *supra* note 109.

133. Wesley C. Mitchell, *Bentham's Felicific Calculus*, 33 *POL. SCI. Q.* 161 (1918) (quoting a manuscript in 3 HALEVY, *RADICALISME PHILOSOPHIQUE* 431).

134. *Id.* Bentham argued that the problem of interpersonal utility comparisons was significant and made any "calculus" of interpersonal pain and pleasure impossible, but that social science could probably proceed on the basis of somewhat less precise interpersonal utility comparisons.

In the process, however, Robbins's ordinalism¹³⁵ completely cut the knot between Darwinism and neoclassical economics. The basis of Robbins's reasoning was that preferences were both autonomous and unique, in that they were strictly non-comparable from one person to another. Further, the only thing one could know about a preference is that it reflected the mental state of the person who asserted it. The logical conclusion was that getting behind the preference to its source was either unscientific, because such inquiries depended on suppositions that could not be tested, or else it was simply outside the boundary of scientific economic inquiry.

The new neoclassicism also required economists to separate the economic conception of "welfare" from the social science conception. The only meaning "value" could have under post-Robbins neoclassicism was observed individual willingness to pay, and welfare was nothing more than the aggregate of individual valuation, which depended on nothing more than the evaluator's state of mind. The economists' welfare became very tightly connected to the competitive market, with the general conclusions being (1) that perfect competition maximizes total social welfare; (2) any governmental interference with the market that is not justified by a market failure either reduces welfare or else has indeterminate welfare consequences; and (3) maldistribution of wealth is not a market failure. By contrast, sociologists and psychologists continued to think of welfare in terms of survival of the species; objective factors such as health, nutrition, shelter, and education; or alternatively (for psychologists) some definition of a sense of well-being or ideas relating well-being to behavior.¹³⁶

One might think the ordinalists were entirely correct as a technical matter, but that they nevertheless drew the wrong implications for legal policy. If the legal policymaker's conception of welfare is limited to subjectively defined preference orderings that are good only for the individual asserting the preferences, then the ordinalists were correct. To that end, the

135. The name "ordinalism" derives from the fact that one can still compare utilities ordinally by observing exchange. For example, if we see A trade two apples for one of B's pears, we can still say that A receives less utility from one additional apple than from one additional pear, but we cannot put any unit (such as inches or pounds) on this measure that we can assume applies equally to both A and B. That is, cardinal measurement is impossible.

136. See, for example, the works by Watson, Pavlov, Weiss, Dewey, Bagley & Colvin, McDougall, and Meyer cited in *supra* note 32.

search for alternative routes to interpersonal utility comparisons seem doomed to failure.

But the Progressive conception of welfare was *not* defined by subjectively asserted preference. As Darwinians, the Progressive social scientists believed that human beings were the product of their own genetic background and environment, and that the "welfare" needs they had in common dwarfed in significance the variations in welfare needs that they perceived individually. For the Progressives, the state was more like the farmer raising crops or cattle. Cows are individuals and can and do assert unique preferences; but the farmer either does not take these preferences into account or else considers them only at the margin (e.g., unusually aggressive, ravenous, ill, or depressed cows might receive distinctive treatment). Over a broad range of questions the farmer defines the welfare of cows by using biological rather than economic tools. For example, she considers the mixture of foods and other environmental qualities that will prevent disease, reduce observed stress and—most importantly—maximize production.¹³⁷

3. Methodological Individualism, Ordinalism, and the Fate of Progressive Legal Thought

Methodological individualism and ordinalism carried two implications for progressive legal thought after 1930. The first was that economists (although not necessarily philosophers) would generally assume as an essential point of methodology that "utility" refers exclusively to mental states and that cardinal orderings of utilities cannot be compared across persons. Second, they would assume that utility information is the *only* kind of information about welfare. To use welfare criteria unrelated to preference is to step outside the boundaries of economic science.

Although much has been written about the first of these constraints (noncomparability of utilities), the second constraint (i.e., only utility information counts) more explicitly defines the emerging gap between neoclassical economics and the thought of the Legal Realists. Progressive legal thinkers really did not devote all that much time to the technical and logical problems inherent in interpersonal utility comparisons. Rather, they simply measured "welfare" by objective criteria unrelated to utility. Increasingly, they relied on "objective"

137. This was fundamentally the analysis of WARD, *supra* note 30.

welfare judgments that inferred utility from categorical observations about survival and productivity. In making such judgments, Progressive legal thought found the social sciences much more useful than economics, which purported to abhor any welfare judgment not based on observed preference.

C. ECONOMIC INSTITUTIONALISM AND LEGAL REALISM

1. Welfare and the External Standard

The external standard refers to the law's insistence that conduct be evaluated without regard to the intent or state of mind of the individual actor, but rather, by considering what the average, reasonable person would have done in equivalent circumstances. The external standard was articulated in the 1870s and 1880s by Thomas M. Cooley writing in torts,¹³⁸ and much more fully by Holmes in *The Common Law*.¹³⁹ Writing mainly as a legal historian, Holmes described the external standard as a device used by courts to add consistency and predictive power to the law.¹⁴⁰ The law can operate only in the sphere of the senses, Holmes noted, and cannot see the hearts or intent of the actors whose conduct it must evaluate. Holmes's student Samuel Williston carried the point much further into the law's technical apparatus. Williston's 1920 treatise on contracts is an extended argument for applying external criteria of evaluation rather than making legal outcomes turn on questions of intent.¹⁴¹

138. See THOMAS M. COOLEY, A TREATISE ON THE LAW OF TORTS 688 (1879) (addressing the place of motive in the law of torts); HORWITZ, *supra* note 25, at 137.

139. OLIVER WENDELL HOLMES, JR., *THE COMMON LAW* (1881). On Oliver Wendell Holmes, Jr., and the external standard, see generally HORWITZ, *supra* note 25, at 110-13, 135-41; DAVID ROSENBERG, *THE HIDDEN HOLMES: HIS THEORY OF TORTS IN HISTORY* 129-31 (1995); Cotter, *supra* note 3; Anne C. Dailley, *Holmes and the Romantic Mind*, 48 DUKE L.J. 429, 452-56 (1998); Thomas C. Grey, *Holmes and Legal Pragmatism*, 41 STAN. L. REV. 787 (1989); William A. Lundquist, Comment, *Oliver Wendell Holmes and External Standards of Criminal and Tort Liability: Application of Theory on the Massachusetts Bench*, 28 BUFF. L. REV. 607, 608-10 (1979).

140. See HORWITZ, *supra* note 25, at 110.

141. See generally SAMUEL WILLISTON, 1 *THE LAW OF CONTRACTS* (1920). In 1 *THE LAW OF CONTRACTS* § 20, Williston notes actual consent is not an element of contract, but merely the "expression" of consent, and concludes:

The parol evidence rule which is of such far reaching importance in determining the existence and meaning of contracts is based on the assumption that where a written memorial of the transaction is made its terms are conclusive. Such a rule is inconsistent with the view

Holmes's development of the external standard occurred during his 1870s participation in the Harvard Metaphysical Club, whose dialogue influenced the American philosophy of pragmatism.¹⁴² Charles Sanders Peirce, in particular, was vehement about the scientific uselessness of talking about things that cannot be observed.¹⁴³ Perhaps Pragmatism's most lasting contribution was the adoption of objective methodologies such as instrumentalism by the post-Darwinian social sciences.¹⁴⁴

External standards are surrogates. The external observer cannot get into the head of the person being observed, so she tries to find useful correlations between observed acts and assumed states of mind. The all-important ingredient in the social science defense of the external standard is Darwinian evolution: state of mind is as much a part of the evolutionary process as any other animal function, and all are motivated by the instinct for survival. Pragmatic instrumentalism, but particularly the work of Holmes, made the external standard central to Progressive analysis of legal policy. Progressives measured not only human responses but also human welfare needs externally. In this sense, the methodology of the external standard was inimical to the developing methodology of neoclassical economics.

But the question of who is scientific and who is engaged in speculation or "politics" is hardly answered by that observation. The neoclassical economists, particularly after Robbins,¹⁴⁵ assumed that the "real" measure of welfare had to be subjectively perceived preference, and the impossibility of interpersonal utility comparisons forever forbade the policymaker from com-

that the mental attitude or assent of the parties is the ultimate juridical fact to be established.

Williston then concluded that the intent to contract was not a part of the law of contract, *see id.* § 21; that legal consideration cannot be determined by the intent of the parties, *see id.* §§ 101, 104; and that the statute of frauds must be broadly construed, *see id.* §§ 448-84, 525-38.

142. *See* 2 ELIZABETH FLOWER & MURRAY G. MURPHY, *A HISTORY OF PHILOSOPHY IN AMERICA* chs. 10-15 (1977).

143. *See generally* 5 CHARLES S. PEIRCE, *THE COLLECTED PAPERS OF CHARLES SANDERS PEIRCE* 358 (Charles Hartshorne & Paul Weiss eds., 1934, 1935) (reprinting CHARLES S. PEIRCE, *THE FIXATION OF BELIEF* (1877)); *id.* at 388 (reprinting CHARLES PEIRCE, *HOW TO MAKE OUR IDEAS CLEAR* (1878)).

144. *See* ROSS, *supra* note 24, at 252-53, 327-30, 405-07. Good recent writing includes Dailey, *supra* note 139, and Chad McCracken, Note, *Hegel and the Autonomy of Contract Law*, 77 TEX. L. REV. 719 (1999).

145. *See supra* notes 88-89 and accompanying text.

paring the strengths of subjectively perceived preferences as between two people.

By contrast, American Pragmatism was much more catholic—indeed, its central tenet is that no form of knowledge is “privileged” in that it claims *a priori* superiority over alternative forms.¹⁴⁶ If the study of individual assertions of preference provides knowledge that is useful for some purpose, then such a study should be deemed scientific and worth pursuing. But one can say the same thing about the study of blood pressure, biological longevity, productivity, or any alternative conception of welfare. If any form of knowledge is privileged, it is “useful” rather than useless knowledge. That is, Pragmatism contained a built-in bias for applied rather than pure science that legal policy naturally found attractive. After the ordinalist revolution, neoclassical welfare economics turned heavily toward theoretical concerns, and most of these appeared to be of only minimal interest to Progressive legal policymakers.

The Pragmatist/social science approach to welfare was also far more congenial to the basic republicanism of Progressive legal thought than was the neoclassical conception of welfare as preference. The principal difference between the classical and republican traditions in American political thought is that the classical tradition believes that social policy must be formed out of the aggregation of individual preferences—i.e., by a social contract, or the consent of the governed. The branch of neoclassical economics we call public choice, or social choice, rests on this proposition. Republicanism, by contrast, believed that government officials should be appointed to represent others; but from that point their obligation was not either to vote their own individual preferences or their conception of the preferences of the group. Rather, it was to make policy judgments about what was best for society, and these judgments might often conflict with the solutions dictated by markets or opinion polls.

Today we have highly technical conceptions about the place of the social contract in political theory. For example, Arrow’s general possibility theorem shows that non-unanimous decision-making in a social system where each participant receives one vote cannot produce stable welfare policies.¹⁴⁷ Arrow’s theorem has two implications: either the decisions have to be

146. See generally, e.g., JOHN DEWEY, *THE QUEST FOR CERTAINTY* (1929).

147. See ARROW, *supra* note 2, at 59-73.

unanimous in order to be said to be the choice of the governed¹⁴⁸ or else government agency identification of the optimal policy must be made by some other means than the aggregation of individual preferences.¹⁴⁹

The most important differences between contractarians and republicans pertain to their attitude toward government. For the contractarian, markets are unambiguously the preferred way to allocate resources (when the social contract is negotiated, markets receive unanimous consent), and the government intervenes only in the extraordinary case where everyone agrees that intervention is in order. As a result, provision of public goods such as national defense is presumed to be permissible¹⁵⁰ but forced wealth transfers generally are not, because the involuntary transferors under such legislation never would have consented to it. By contrast, republicans believe that government policies should be based on objective welfare judgments about human needs. The Progressive conception of law as a social control device, together with their general distrust of markets, generally drove them away from the social contract and toward republican alternatives.

2. The Fate of Economic Institutionalism

Institutionalism in economic thought is as difficult to define as its near twin, Legal Realism, is in legal thought.¹⁵¹ The institutionalists were a diverse group of thinkers who disagreed about many things. Indeed, perhaps the only proposition they agreed about is the negative one that there are serious conceptual problems with neoclassical economics. Institutionalism was popular during the first two decades of the twentieth century, thanks largely to the writing of Progressives such as Veblen, Ely, Commons, Seligman, Hale, and Wesley Mitchell in the United States, and John A. Hobson in England. In the

148. As in JAMES M. BUCHANAN, *THE LIMITS OF LIBERTY: BETWEEN ANARCHY AND LEVIATHAN* 35-52 (1975).

149. See generally Hovenkamp, *supra* note 86.

150. But see Herbert Hovenkamp, *Rationality in Law & Economics*, 60 GEO. WASH. L. REV. 293, 333-36 (1992) (stating that even proposals respecting public goods are subject to Arrowian cycling and failure of equilibrium).

151. In addition to the work of Veblen, Commons, Seligman, and Mitchell cited previously, see Charles H. Cooley, *The Institutional Character of Pecuniary Valuation*, 18 AM. J. SOC. 543, 546-50 (1913); Morris A. Copeland, *Economic Theory and the Natural Science Point of View*, 21 AM. ECON. REV. 67, 68 (1931); Lionel D. Edie, *Some Positive Contributions of the Institutional Concept*, 41 Q.J. ECON. 405, 420-21 (1927).

1920s, institutionalism began to become marginalized within economics and by the 1930s institutionalists were virtual *personae non grata* within orthodox economic circles, including the American Economic Association, which was founded as a Progressive alternative to traditionalism but turned quickly to the right.¹⁵²

Intellectual historians in the Progressive tradition have always been drawn to institutionalism. As a result, the institutionalist movement tends to occupy a position in the intellectual histories of the period that is out of proportion to its influence on economics itself. For example, Veblen's work is often given lengthy treatment, while the much more technical and influential work of John Bates Clark or Irving Fisher is ignored or given only brief mention.¹⁵³ The marginalist revolution working its way out in economics departments in the first three decades of the twentieth century was certainly as interesting and proved to be far more durable within economics than anything institutionalism offered; however, it was also more technical, and the writing was addressed to other professional economists rather than a broad range of policymakers. The result was that intellectual historians ignored it until relatively recently.¹⁵⁴

At the risk of oversimplification, the institutionalists were evolutionists who believed that the study of economics could not be divorced from such questions as the social and biological origins of human preference and welfare. The institutionalists also had much less faith than neoclassicists did in conventional markets, and they believed that "institutions," rather broadly defined, acted as market substitutes. Institutions are groups of individuals that collectively form rules for allocating resources,

152. See A.W. Coats, *The First Two Decades of the American Economic Association*, 50 AM. ECON. REV. 555 (1960); Richard T. Ely, *The Founding and Early History of the American Economic Association*, 26 AM. ECON. REV. 141 (Supp. 1936).

153. See generally HENRY STEELE COMMAGER, *THE AMERICAN MIND* 227-46 (1950) (containing lengthy discussion of Veblen while John Bates Clark, who is mentioned once, is incorrectly lumped with the "classical economists"); RICHARD HOFSTADTER, *THE AGE OF REFORM* (1955) (containing three mentions of Veblen; none of Clark); MORTON WHITE, *SOCIAL THOUGHT IN AMERICA: THE REVOLT AGAINST FORMALISM* (1947) (containing numerous references to Veblen; none to Clark or Fisher).

154. Recent examples taking marginalism into account are BARBARA H. FRIED, *THE PROGRESSIVE ASSAULT ON LAISSEZ FAIRE: ROBERT HALE AND THE FIRST LAW AND ECONOMICS MOVEMENT* (1998); ROSS, *supra* note 24; Hovenkamp, *supra* note 21.

and these rules might be quite different from those dictated by the market. One institution is the market itself, but corporations, families, churches, political parties, the judicial system, and clubs are all institutions. Institutionalism was heavily influenced by Edward Ross's conception of "social control," which saw a wide variety of social institutions as control devices regulating human behavior.¹⁵⁵ For John Commons, perhaps the most formal of the institutionalists, allocation decisions within the institution are a product of "working rules" and "transactions."¹⁵⁶ A working rule is a rule that the institution uses for deciding how an allocation decision should be made (e.g., "father knows best," or, one vote for each outstanding share of common stock). A transaction then refers to a particular decision to allocate a resource in a particular way.

Finally, institutionalists believed that each of society's various institutions was unique, and that the working rules of each were proper subjects for economic study. This naturally demanded a great deal of empirical work, and the domain over which this research applied was quite limited. For example, one might do empirical studies of how and why business corporations make decisions by observing their working rules and the resulting transactions. Or one might do the same thing for families, the judicial system, or municipal government. But the generalizations that one might develop for individuals or traditional markets would not necessarily apply to corporations, families, local governments, or any other institution, and even those that applied to one business firm structure might not apply to another.

To give just one well-known example, institutionalists emphasized that an important characteristic of the modern business corporation was the separation of ownership and control—the fact that shareholders were absentee and managers represented only a small part of the ownership interest.¹⁵⁷ This separation was thought to imply that the business corporation was either less efficient or more dangerous than smaller pro-

155. See ROSS, *supra* note 30.

156. See JOHN R. COMMONS, *LEGAL FOUNDATIONS OF CAPITALISM* 67-68, 121 (1924).

157. See generally ADOLPH A. BERLE, JR. & GARDINER C. MEANS, *THE MODERN CORPORATION AND PRIVATE PROPERTY* (1932); ROBERT S. BROOKINGS, *INDUSTRIAL OWNERSHIP: ITS ECONOMIC AND SOCIAL SIGNIFICANCE* (1925); THORSTEIN VEBLEN, *ABSENTEE OWNERSHIP AND BUSINESS ENTERPRISE IN RECENT TIMES: THE CASE OF AMERICA* (1923).

prietorships.¹⁵⁸ More generally, corporations are not rational maximizers in the same way that individuals are, and thus a different set of market rules must be applied to them.

Neoclassicists either disputed such conclusions, minimized their significance, or ignored them, believing that the study of economic transactions was a study of markets, and that the various forms that an economic actor might take provoked only modest deviation from the neoclassical model of exchange. Generalization and abstraction were the essence of neoclassicism. Indeed, institutionalism's inability to devise testable, general hypotheses explains why it failed to capture the minds of the young economists of the 1930s and later. Institutionalists were always doing elaborate empirical studies about single firms, industries or other institutions, but all of the conclusions seemed quite descriptive and idiosyncratic, with no unifying theory to hold them together. Empirical studies by the Legal Realists tended to meet the same fate.¹⁵⁹ Within the mainstream of economics institutionalism died in the late 1920s and early 1930s.¹⁶⁰ The debates in the AEA's *American Economic Review* became much more notable for attacks on institutionalism than for the institutionalist contributions themselves.¹⁶¹

158. See generally BERLE & MEANS, *supra* note 157.

159. See *infra* text accompanying notes 173-74.

160. For a general treatment of institutional economics in the United States, see HEATH PEARSON, *ORIGINS OF LAW AND ECONOMICS: THE ECONOMISTS' NEW SCIENCE OF LAW, 1830-1930* (1997); James R. Hackney, Jr., *Law and Neoclassical Economics: Science, Politics, and the Reconfiguration of American Tort Law Theory*, 15 *LAW & HIST. REV.* 275 (1997); James J. Heckman, *The Intellectual Roots of the Law and Economics Movement*, 15 *LAW & HIST. REV.* 327 (1997); Hovenkamp, *supra* note 18; Herbert Hovenkamp, *Law and Economics in the United States: A Brief Historical Survey*, 19 *CAMBRIDGE J. ECON.* 331 (1995). See also the interesting panel discussion in Douglas G. Baird, *The Future of Law and Economics: Looking Forward*, 64 *U. CHI. L. REV.* 1129 (1997).

161. See, e.g., Paul T. Homan, *An Appraisal of Institutional Economics*, 22 *AM. ECON. REV.* 10, 10-17 (1932); *Institutional Economics*, 22 *AM. ECON. REV.* 105-16 (Supp. 1932) (panel discussion).

3. Institutionalism and Legal Realism¹⁶²

Legal Realism is notable for its numerous interdisciplinary outreaches in psychology, sociology, anthropology, and political science. But Legal Realism never reached the same accommodation with economics. *First*, Legal Realists generally found the other social sciences more useful than economics for the analysis of legal rules. *Second*, the economics that they turned to was decidedly out of favor among economists themselves. The Legal Realists were incurable institutionalists, in both law and economics. Scattered among the amateur and a few professional social scientists who considered themselves to be Legal Realists were a few economists. By and large, however, they stood outside or at the margins of the neoclassical economic tradition. For example, just as Karl Llewellyn was underscoring the Legal Realist belief that legal conceptions should be cut up into smaller pieces for purposes of analysis,¹⁶³ neoclassical economists were rejecting market-specific institutional approaches and trying to develop generalized theories that would explain all parts of the economy.

To be sure, the Legal Realists were an extraordinarily diverse group of thinkers, and generalizing about them is difficult. But they generally shared Roscoe Pound's belief that legal study should focus on the institutions that make and administer the law.¹⁶⁴ Indeed, on this score they were deeply indebted

162. On Legal Realism, see HORWITZ, *supra* note 25, at 169-92. See generally GARY JAN AICHELE, *LEGAL REALISM AND TWENTIETH-CENTURY AMERICAN JURISPRUDENCE: THE CHANGING CONSENSUS* (1990); G. Edward White, *From Sociological Jurisprudence to Realism: Jurisprudence and Social Change in Early Twentieth-Century America*, 58 VA. L. REV. 999 (1972). A particularly good analysis of legal realism's basic analytic approach, less cluttered by *au courant* ideology than many others, is Brian Leiter, *Rethinking Legal Realism: Toward a Naturalized Jurisprudence*, 76 TEX. L. REV. 267 (1997). On the Legal Realists' empirical work in the social sciences, see JOHN HENRY SCHLEGEL, *AMERICAN LEGAL REALISM AND EMPIRICAL SOCIAL SCIENCE* (1995). On the institutional nature of the Legal Realists' economics, see Allen R. Kamp, *Between-the-Wars Social Thought: Karl Llewellyn, Legal Realism, and the Uniform Commercial Code in Context*, 59 ALB. L. REV. 325 (1995); Oliver E. Williamson, *Revisiting Legal Realism: The Law, Economics, and Organization Perspective* (1996) (unpublished paper, in conjunction with University of California Berkeley, Program in Law and Economics Working Paper) (on file with author).

163. See Karl N. Llewellyn, *Some Realism About Realism—Responding to Dean Pound*, 44 HARV. L. REV. 1222, 1237 (1931). Llewellyn was responding to Roscoe Pound, *The Call for a Realist Jurisprudence*, 44 HARV. L. REV. 697 (1931).

164. On the indebtedness of the Legal Realists (particularly Llewellyn) to Pound, and the stormy relations that developed later, see generally HORWITZ, *supra* note 25, at 169-92; N.E.H. Hull, *Reconstructing the Origins of Realistic Juris-*

to Pound, who had practically turned the study of law into a study of legal institutions. Whether they spoke of sociology and social control,¹⁶⁵ anthropology,¹⁶⁶ Freud and the fact-finding power of courts,¹⁶⁷ anti-conceptualism,¹⁶⁸ limitations on the legal process,¹⁶⁹ the role of the contract in modern society,¹⁷⁰ or the coercive power of the laissez faire state,¹⁷¹ the one thing the Legal Realists shared was an abhorrence of abstractions, particularly powerful traditional abstractions such as the "market" played in classical and neoclassical economics.

Although Legal Realists talked much about law and the social sciences, Legal Realism was hardly a law and economics movement.¹⁷² Indeed, Legal Realists taught law and every so-

prudence: A Prequel to the Llewellyn—Pound Exchange Over Legal Realism, 1989 DUKE L.J. 1302; N.E.H. Hull, *Some Realism about the Llewellyn—Pound Exchange Over Realism: The Newly Uncovered Private Correspondence, 1927-1931*, 1987 WIS. L. REV. 921.

165. See generally Thurman W. Arnold, *Law Enforcement—An Attempt at Social Dissection*, 42 YALE L.J. 1 (1932); Underhill Moore & Theodore S. Hope, Jr., *An Institutional Approach to the Law of Commercial Banking*, 38 YALE L.J. 703 (1929); Underhill Moore & Charles Callahan, *Law and Learning Theory: A Study in Legal Control*, 53 YALE L.J. 1 (1943).

166. See generally KARL N. LLEWELLYN & E. ADAMSON HOEBEL, *THE CHEYENNE WAY* (1941); Huntington Cairns, *Law and Anthropology*, 31 COLUM. L. REV. 32 (1931).

167. See generally JEROME FRANK, *LAW AND THE MODERN MIND* (1930).

168. See generally Karl N. Llewellyn, *A Realistic Jurisprudence—The Next Step*, 30 COLUM. L. REV. 431 (1930).

169. See generally FRANK, *supra* note 167; Charles E. Clark, *Fact Research in Law Administration*, 2 CONN. B.J. 211 (1928); John Dickinson, *Legal Rules: Their Function in the Process of Decision*, 79 U. PA. L. REV. 833 (1931); William O. Douglas & J. Howard Marshall, *A Factual Study of Bankruptcy Administration and Some Suggestions*, 32 COLUM. L. REV. 25 (1932).

170. See generally, e.g., Karl N. Llewellyn, *What Price Contract?—An Essay in Perspective*, 40 YALE L.J. 704 (1931).

171. See generally, e.g., Robert L. Hale, *Coercion and Distribution in a Supposedly Non-Coercive State*, 38 POL. SCI. Q. 470 (1923).

172. Morton Horwitz's conclusion that Legal Realists "pursued their attack on the legitimacy of the market with a degree of insight, brilliance, and social passion that has never been equaled since" certainly captures their basic attitude towards classical political economy, but it misstates their focus. See HORWITZ, *supra* note 25, at 195. This may be a projection of the Critical Legal Studies scholarship onto the Realists, but in any event, Horwitz discusses only Hale and Dawson, neither of whom were among the most prominent Legal Realists. Further, Hale's influential essay, *Coercion and Distribution in a Supposedly Non-Coercive State*, 38 POL. SCI. Q. 470 (1923), is not so much an attack on the legitimacy of the market as it is a call for a new understanding of the market that was more sensitive to its coercive features. For example, he chastised the orthodox defense of "liberty of contract" because it contrasted the supposed liberty of the market against the coercion of state interference. See *id.* In fact, Hale argued,

cial science but largely excluded neoclassical economics from their teachings.¹⁷³ Although they touted the social sciences, the brand of social science that the Legal Realists practiced was more empirical than positive and more statistical than theoretical. They did this even in commercial areas that expressly invoked the market, and where the influence of traditional economics seemed obvious.¹⁷⁴

Institutionalist economics fit very well into this framework, while the much more abstract and theoretical neoclassicism did not. Even Robert L. Hale, who wrote mainly about law and economics but is often grouped today with the Legal Realists,¹⁷⁵ is no exception. Hale, a trained economist who had a joint appointment in law and economics at Columbia, wrote mainly in the field of price-regulated industries. He dedicated his career to illustrating imperfections in the market that might justify non-market intervention. He was a thoroughgoing institution-

the relevant choice was between two types of coercion, market coercion or coercion by government decision. See, e.g., *id.* at 470 (contending laissez faire systems themselves are "permeated with coercive restrictions of individual freedom" and the restrictions are inconsistent with equal opportunity or preservation of the rights of others). This new understanding was generally consistent with the view of neoclassical economists that the classicists had exaggerated the degree of freedom that markets permitted. See HOVENKAMP, *supra* note 25, at 226-30 (labor); *id.* at 268-95 (competition and antitrust). But see Richard Epstein, *The Assault That Failed: The Progressive Critique of Laissez Faire*, 97 MICH. L. REV. 1697 (1999); Richard A. Epstein, *Life Boats, Desert Islands, and the Poverty of Modern Jurisprudence*, 68 MISS. L.J. 861 (1999).

173. See LAURA KALMAN, *LEGAL REALISM AT YALE, 1927-1960*, at 153-54 (1986) (describing Yale curriculum in the 1940s). See generally John Henry Schlegel, *American Legal Realism and Empirical Social Science: From the Yale Experience*, 28 BUFF. L. REV. 459 (1979).

174. See generally, e.g., Underhill Moore & Theodore S. Hope, Jr., *An Institutional Approach to the Law of Commercial Banking*, 38 YALE L.J. 703 (1929) (taking a Commons-like approach in grouping organizations by the nature of the transactions they make); Underhill Moore & Gilbert Sussman, *Legal and Institutional Methods Applied to the Debiting of Direct Discounts—III. The Connecticut Studies*, 40 YALE L.J. 752 (1931). For other articles in the *Legal and Institutional Methods Applied to the Debiting of Direct Discounts* series by Moore and Sussman, see 40 YALE L.J. 381, 555, 752, 928, 1055, 1219 (1931). For an accounting of Moore's research methodology, see John Henry Schlegel, *American Legal Realism and Empirical Social Science: The Singular Case of Underhill Moore*, 29 BUFF. L. REV. 195, 244-250 (1980); see also William Clark et al., *The Business Failures Project—A Problem in Methodology*, 39 YALE L.J. 1013 (1930) (discussing a study of bankruptcy administration); William O. Douglas, *A Functional Approach to the Law of Business Associations*, 23 ILL. L. REV. 673 (1929); Douglas & Marshall, *supra* note 169 (discussing the process and flaws of a scientific study of the causes of bankruptcy).

175. See, e.g., FRIED, *supra* note 154, at 10-15.

alist, and should be compared more with Veblen or Commons than with Llewellyn or Frank.¹⁷⁶

Writing in the *American Economic Review* in 1919 and 1925, Legal Realists Walton Hamilton and Karl Llewellyn both tried to defend jurisprudential use of institutionalist economics to an audience of economists. Hamilton objected to the excessive abstraction in neoclassical economic theory, and argued that only an institutional approach to economics was sufficiently comprehensive to account for the workings of markets, government, and the full range of social phenomena that people encountered in their lives.¹⁷⁷ After all, political institutions affect markets all the time.¹⁷⁸ He also argued that the neoclassical urge to make economics more scientific by separating it from any political agenda was wrong-headed. Classical political economists always had expressly political agendas, and much classical writing had been intended as political tracts rather than contributions to pure theory.¹⁷⁹ Together with the social value theorists,¹⁸⁰ Hamilton also argued that economics needed to be grounded in a more acceptable theory of human behavior, which considered the source of preference rather than just the preferences themselves.¹⁸¹

But Hamilton was preaching to the wrong audience. He was correct that the classicists had always written with policy concerns in mind. But neoclassicism, particularly since Alfred Marshall,¹⁸² had been fairly obsessed with turning economics into a science, thus distinguishing the "economics" of the twentieth century from the "political economy" of the nineteenth. Marginalism promised to substitute mathematics for policy as the underlying unifier of economic theory. Hamilton's paper was met with a volley of criticism from economists. Lewis H.

176. See generally Robert L. Hale, *Bargaining, Duress and Economic Liberty*, 43 COLUM. L. REV. 603 (1943); Hale, *supra* note 172; Robert L. Hale, *Value to the Taker in Condemnation Cases*, 31 COLUM. L. REV. 1 (1931). For further discussion about Hale, see FRIED, *supra* note 154; Neil Duxbury, *Robert Hale and the Economy of Legal Force*, 53 MOD. L. REV. 421 (1990); Warren J. Samuels, *The Economy as a System of Power and Its Legal Bases: The Legal Economics of Robert Lee Hale*, 27 U. MIAMI L. REV. 261 (1973); Schlegel, *supra* note 174, at 209 & n.70.

177. See generally Walton H. Hamilton, *The Institutional Approach to Economic Theory*, 9 AM. ECON. REV. 309 (Supp. 1919).

178. See *id.* at 314-15.

179. See *id.* at 312-13.

180. See *supra* notes 64-84 and accompanying text.

181. See Hamilton, *supra* note 177, at 316-17.

182. See generally MARSHALL, *supra* note 40.

Haney thought Hamilton's institutionalism was nothing more than a throwback to the historical economics of the late nineteenth century, which contained no theory whatsoever and was concerned mainly with giving full factual accountings of the institutions it observed, and making policy recommendations to the state.¹⁸³ He believed that "Professor Hamilton will not be able to develop any laws or build a science, but that his proposal will merely lead to an ever changing description of an ever changing environment."¹⁸⁴ Haney then suggested that economics was not like the other social sciences:

No one will deny that the various social sciences are closely inter-related; but many will hold that it is a wise division of labor that the economist should confine his attention to economic motives and economic values. There are different levels of valuation, so to speak—ethical, political, religious, aesthetic, and economic. There is ample room for a distinct and separate science of economics to deal with this last class of values.¹⁸⁵

Six years later, Karl Llewellyn offered the economists a quite different defense of institutionalism. Law itself is a costly, scarce resource, Llewellyn argued.¹⁸⁶ As a result, economic decisions continually must be made concerning how the resources given to law are to be allocated. "As governmental energy is put to blocking robbery, it is drawn off of prohibition. As the motor car gives criminals power to strike and get away, the output of energy needed to block robbery increases."¹⁸⁷ The value of economic institutionalism for law is that it puts economics to the task of informing policymakers about how scarce resources should best be allocated. Llewellyn suggested that areas deserving economic study were the use of form contracts to reduce the overall costs of numerous similar transactions,¹⁸⁸ the use of administrative agencies and rule-making as less costly substitutes for the legislative process,¹⁸⁹ and the use of arbitration as a less costly alternative to litigation.¹⁹⁰

183. See Lewis H. Haney, *Economic Theory—Discussion*, 9 AM. ECON. REV. 320, 321 (Supp. 1919).

184. *Id.*

185. *Id.*

186. See Karl N. Llewellyn, *The Effect of Legal Institutions Upon Economics*, 15 AMER. ECON. REV. 665, 666 (1925).

187. *Id.* at 668.

188. See *id.* at 673-75. Llewellyn concluded that in the one area that he had studied, motion picture distribution contracts, standardized forms had been very successful in reducing legal costs. See *id.* at 674.

189. See *id.* at 671-72.

190. See *id.* at 674-76.

If Walton Hamilton's institutionalism was a throwback to the work of Veblen, Llewellyn's idea that economists should study the costs of the legal system was many years ahead of its time, anticipating the more Coasian institutionalism of a later generation.¹⁹¹ The legal system allocates resources by means of costly devices, and markets, corporations, families and other institutions operate as alternatives. A worthy subject of economic study is the comparative costs of these alternatives, as well as the possible mechanisms that can reduce or eliminate various transaction costs. Within this framework, an institution is an organization that behaves as a single economic actor to the extent that such behavior enriches the members more than does the use of a market. This conception of the institution, which began with the premise of maximizing, rational actors, promised to reunite institutionalism with neoclassical orthodoxy.

Llewellyn did not use the term "transaction costs," and he did not have Coase's perspective on the irrelevance of the legal system under an efficient bargaining regime. But he did offer the one "institutional" perspective on economics and the legal system that could have permitted law and economics to survive into the 1930s: namely, that economists should devote their methodologies to assessing the costs and benefits of various procedural and substantive aspects of the legal system. He then recommend where legal policy might be improved.¹⁹²

In the final analysis, the work of the Legal Realists in the 1930s was no more economic than Pound's work in the first two decades of the twentieth century. Further, although the Legal Realists were enamored of the social scientists, they generally remained empiricists while economists and even social scientists themselves were developing more positivistic methodologies. The Legal Realists who engaged in social science research were generally obsessed with facts, constantly overwhelmed by their variety and number,¹⁹³ and found it difficult to do much with theory. The theory, when it came, was generally about le-

191. For a discussion of Coasian institutionalism, see generally R.H. COASE, *THE INSTITUTIONAL STRUCTURE OF PRODUCTION* 9 (1991); Ronald H. Coase, *The New Institutional Economics*, 27 *J. INSTITUTIONAL & THEORETICAL ECON.* 229 (1984). However, the origins can be found in R.H. Coase, *The Nature of the Firm*, 4 *ECONOMICA* 386 (1937); see also Oliver E. Williamson, *Kenneth Arrow and the New Institutional Economics*, in *ARROW AND THE FOUNDATIONS OF THE THEORY OF ECONOMIC POLICY* 584, 585, 592 (Geo. R. Feiwel ed., 1987).

192. See *supra* notes 186-90 and accompanying text.

193. See generally, e.g., FRANK, *supra* note 167.

gal process rather than legal substance.¹⁹⁴ Further, the love affair with the social sciences eventually wore off. In the late 1940s, Jerome Frank lamented that the social sciences were not "science" at all. They produced no laws or rules in the scientific sense, but only mountains of incoherent data. Further, economics was the worst of the lot: it not only produced mountains of meaningless data, but it then used the data on the assumption that human preferences and behavior would remain constant, when in fact everyone knew that customs and preferences are continually evolving.¹⁹⁵

V. CONCLUSION: THE SPLINTERING OF THE PROGRESSIVE COALITION AND THE REHABILITATION OF THE MARKET

Legal Realism was one of progressive legal thought's most important legacies. The New Deal was another, and the continuing, dramatic growth of government during and after the Second World War was yet another. During this period elite legal, political and historical thought was dominated by the Progressive critique, which was republican in its idea of government, disdainful of private markets, expansive in its ideas about the domain and efficacy of government regulation, and much more concerned with equality than with efficiency. In legal thought, economics took a back seat to the social sciences. Indeed, even in areas such as antitrust, where one would expect traditional economic concerns to dominate, the articulated concern became one of leveling the playing field as between big and little firms, even at the expense of substantial production inefficiencies and higher consumer prices.¹⁹⁶

194. See, e.g., HENRY M. HART, JR. & ALBERT SACKS, *THE LEGAL PROCESS: BASIC PROBLEMS IN THE MAKING AND APPLICATION OF LAW* (William N. Eskridge, Jr., & Philip P. Frickey eds., 1994) (prepared from 1958 tentative edition). This work was heavily influenced by Legal Realism and consumed by the institutionalist approach to law. In this regard, the Legal Realists were indebted to Pound, who also wrote more about legal institutions and legal process than about substantive law. See generally, e.g., Roscoe Pound, *Courts and Legislation*, 7 AM. POL. SCI. REV. 361 (1915); Roscoe Pound, *Justice According to Law* (pts. 1-3), 13 COLUM. L. REV. 696 (1913), 14 COLUM. L. REV. 1, 103 (1914); *supra* notes 91, 98-100, 163. On the Legal Realists increasing concern with procedure, see Schlegel, *supra* note 173, at 495-519. On Hart and Sacks, see ANTHONY J. SEBOK, *LEGAL POSITIVISM IN AMERICAN JURISPRUDENCE* 129-78, 315-17 (1998).

195. See JEROME FRANK, *COURTS ON TRIAL: MYTH AND REALITY IN AMERICAN JUSTICE* 209, 210 & n.62 (1949).

196. See, for example, the 1950 Celler-Kefauver amendments to the anti-merger statute, 15 U.S.C. § 18 (1994); see also H.R. REP. No. 81-1191, at 2-3

The Great Society and welfare and civil rights expansion of the 1960s thus mark the end rather than the beginning of an era. Intellectually, Progressive legal policy had already run out of gas. A new regime turned the study of government back to the premises of individual preference and the social contract,¹⁹⁷ and then turned the study of legal conflict to private bargaining under generally neoclassical conditions.¹⁹⁸

Why did the Progressive ideal last as long as it did, and why did it finally fall apart? Unlike the welfare liberalism of the Democratic Party since the 1960s, Progressive legal thought was dominated by a single agenda item: maldistribution of wealth and the resulting inequities and suffering. Both the Progressive coalition of the turn of the century and the New Deal coalition of the 1930s and 1940s were relatively cohesive politically because their principal political concerns were economic and were generally addressed to the wage earner, the unemployed, the underemployed poor, or the elderly poor. In a system where each person gets one vote and wealth is badly distributed those earning less than the median can form a powerful political coalition.

The Progressive coalition, just as many others, became a victim of its own success. The economic failures of the Depression and the costs of the War gave way to the relative comfort and security of the 1950s. The Progressive concern began to shift away from wealth and toward other indicia of lack of privilege, such as race, extremist political or social views, indigent criminal defendants, alienage, and eventually gender, affectional preference and disabilities. Although *Brown v. Board of Education* and the Civil Rights movement were essential steps to fairness, they came at a price: the new Progressive concerns tended to divide rather than unite the coalition that had supported it. Since the 1960s politically active Democratic Party liberals have increasingly played the game of recognizing new groups as disadvantaged while losing or risking the alle-

(1949) (discussing goals of merger policy as protecting smaller firms from larger, lower cost rivals). The new merger policy, designed to prevent small high cost firms from being "gobbled up" by larger, more efficient firms was hailed as a triumph of law and economics. Cf. Derek Bok, *Section 7 of the Clayton Act and the Merging of Law and Economics*, 74 HARV. L. REV. 226, 226-31, 238-48 (1960); Herbert Hovenkamp, *Derek Bok and the Merger of Law and Economics*, 21 U. MICH. J.L. REFORM 515, 521-22 (1988).

197. See generally ARROW, *supra* note 2; BUCHANAN & TULLOCK, *supra* note 15.

198. See generally Coase, *supra* note 11.

giance of others. At its best, the democratic coalition has been barely held together by its fear of the political alternative. At its worst, it has been a set of bickering groups struggling for recognition as disadvantaged so that its members can also become the beneficiaries of government largesse. Meanwhile, government entitlement programs began to move up the social scale until their principal beneficiaries became, not the poor and unemployed, but the employed and successful middle class.¹⁹⁹

The Progressives left a powerful legacy in their theory of welfare. Their use of objective welfare judgments serves to remind us that technical methodologies in the social sciences are used for a purpose, that they rarely lack alternatives, and that the search for methodological elegance and sophistication should never trump the search for answers. Neoclassical welfare economics under the ordinalists became so lashed to the mathematical complexities and constraints of its conception of welfare that it lost the ability to consider whether the conception was correct or—more relevantly—whether it was useful for the purpose at hand.

199. See generally GORDON TULLOCK, *ECONOMICS OF INCOME REDISTRIBUTION*, 111-50 (1983); GORDON TULLOCK, *THE ECONOMICS OF SPECIAL PRIVILEGE AND RENT SEEKING* (1989).